

The Political Economy of Labor Market Mediation in the United States

Anthony P. Carnevale and Donna M. Desrochers
Educational Testing Service

Introduction

Broadly conceived, labor market intermediaries are the set of informal conventions, public and private institutions, as well as public laws and regulations, that link individuals and communities with market economies. In concept, the scope of labor market intermediation includes a broad array of functions such as human capital development, supportive social services, employment services, income security, housing, and health care as well as a voice in economic and social decision making. While the dialogue among the European nations on the public role in labor market intermediation has been expansive, the American dialogue on “workforce intermediaries” has been narrowly focused on facilitating “work-first” policies that encourage permanent transitions from public dependency to private employment.

The public dialogue on the structure of labor market intermediaries in the United States is consistent with a unique cultural emphasis on economic individualism, a political preference for limited government, and an economic strategy that emphasizes deregulation and flexibility as a core competitive asset. As a result, the evolution of labor market intermediaries has been characterized by a privatized, market-based, and fragmented provision of skill development, job search and hiring, as well as similar trends in access to child care, health care, and pensions.

But as the United States moves farther into the post-industrial era, the dialogue on the scale and scope of public intermediaries may become re-energized. Systemic changes in both economic and employment relationships suggest a growing need for public intermediation to encourage efficiencies and mitigate inequalities in the labor market. Competition in the global marketplace and the pace of change have intensified, and finding skilled workers has become more important to employers as they try to maintain an edge in product and service markets. Declining job security increases workers’ needs for intermediary services to find new jobs and maintain benefits coverage. And with the retirement of the baby-boom population on the horizon, labor markets will tighten and labor shortages will likely reach unprecedented levels, especially among skilled workers. Efficient allocation of human resources will be critical if we are to maintain our economic competitiveness.

At the same time, unskilled workers are increasingly competing against low-wage production workers abroad, or are employed in low-paying service jobs with minimal, if any, benefits that offer few internal career ladders or learned skills that allow their next job to be a better job. Economic inequality has persisted between the nation's most and least fortunate throughout the 1990s, fueling skepticism on the efficacy of "a rising tide lifting all boats" since inequality has narrowed only slightly, and well after the longest economic expansion in post-war history was solidly underway. Changes in the employment structure have given rise to "poverty traps" that, for many, are not easily escaped simply by going to work.

The case for expanding the scale and scope of labor market intermediaries in the United States is compelling. Nevertheless, support for the development of a more pervasive intermediary system waxes and wanes with the economic tides. To a large extent, the education system has already become the primary, or "first-chance," institutional intermediary for distributing economic opportunity and subsequent access to further learning and private benefits. The United States has struggled to develop workforce intermediaries as part of a "second-chance" system for those who are excluded or dislocated from mainstream education institutions, but the "second-chance" system has never achieved a scale sufficient to serve a majority of those eligible or to change aggregate income patterns.

Expansion in labor market mediation faces intellectual as well as financial barriers. While the U.S. market-based system of intermediaries is criticized for its regressive distributional impact, it is generally applauded for its flexibility in response to economic change—especially in comparison with the European welfare states. Advocates of the American system claim that American flexibility improves economic adaptability, promotes job creation, minimizes credentialing barriers to individual opportunity, and reduces public dependency. The flexibility and fragmentation of the American system also is deemed by many as especially appropriate for 21st century labor markets that are, themselves, fragmenting and changing rapidly.

Advocates for an expansion in the scope and scale of publicly funded workforce intermediaries dispute these claims. First, proponents argue that increased public intermediation in labor markets would improve rather than discourage labor market flexibility. They argue that the empirical evidence of a demonstrable connection between economic rigidity and expanding access to intermediary services such as job search and retention services, child care, education and training, and health care is weak or non-existent—even in the European case. They make the

intuitively compelling argument that an expansion in the scale and scope of workforce intermediaries would increase, not decrease, flexibility. In addition, workforce intermediaries targeted toward the least advantaged 15 percent of the labor force would benefit those served but would have little impact on the overall flexibility of the labor market. Their minimal impact would result from their relatively small size and the fact that they are focused on people who are at the fringes, rather than the core, of the labor force.

Second, advocates for expanding the skill development functions of workforce intermediaries argue that education and training are necessary intermediary functions for overcoming rising skill barriers to sustained employment in jobs that pay enough or provide enough income mobility for real social inclusion.

Third, there is convincing evidence that social changes in the structure of families justify new intermediary functions. Women have increased their labor market participation, profoundly changing the economics of family life. In a society whose youth and adult labor force is fully mobilized, support for new capabilities that mediate between work requirements and family needs becomes crucial. In addition, the traditional system of intermediaries may have become outmoded with the growing diversity of household structures that has accompanied the aging of the workforce and the decline in the prevalence of the traditional paternalism of the heterosexual male-headed household.

Fourth, many argue that increased public commitments to workforce intermediaries are necessary to compensate for declining private commitments between employers and workers that have led to reduced trust and a loss of individual economic autonomy critical to a democratic society. In this view, the pursuit of market flexibility has shifted too much risk to workers and too much power to employers. Many analysts argue that this decline in labor power, in conjunction with increasing skill requirements, has been especially detrimental to low-wage families. They argue that it has resulted in a declining real value of the minimum wage as well as new policy barriers to an equitable distribution of education, training, affordable housing, health care, and legal services. These changes, along with declining union membership, are portrayed as the dominant cause of the dramatic decline in the relative wages of workers with high school or less as well as the growing dispersion in family incomes.

Fifth, advocates for increased public intermediation point toward fundamental demographic changes that will necessitate more aggressive public interventions in labor markets

to ensure growth and prosperity. Baby-boom retirements, along with a dramatic falloff in college-level attainment, will result in equally dramatic worker shortages, especially among skilled workers. The combined effects of flat labor force participation rates, baby-boom retirements, and a slowdown in educational attainment could result in an overall shortage of more than 20 million workers by 2020, including a shortage of 14 million highly skilled workers with at least some education or training beyond high school. These demographic, economic, and educational trends will ultimately shape labor market intermediaries in the United States in the next few decades.

The Flexibility Debate

Support for intermediaries, even “workforce intermediaries” narrowly targeted toward the disadvantaged, has been frustrated by a broader bias against public intervention in labor markets. Many believe that public interventions of any kind will create barriers to flexible adaptation to economic change both among companies and individual workers. Moreover, flexibility is aggressively protected because it is widely regarded as America’s unique and key economic asset in global competition and in minimizing public dependence among individuals.

Because of its allegiance to market-based flexibility, the American labor market is qualitatively different from those in other nations. It tends to cluster with Britain, Australia, New Zealand, Canada, and other more market-oriented systems. By way of comparison, workforce intermediaries in the market-oriented systems have less scale and scope than the Nordic, German, and southern European systems, which are based on highly structured and aligned social partnerships among education institutions, unions, and employers at both the policy and operational levels.

Both the European and American systems have costs and benefits. Many European nations use their dense, nationwide institutional networks to provide strong social supports and economic security by linking employment, education, and training with other intermediary services (Shavit and Muller, 1998). Critics of the European model find its dense institutional networks a barrier to flexible, fast responses to economic and technological changes, as well as the source of incentives that distort resource allocation, impair efficiency, and encourage dependency (Esping-Andersen, 1996; Heckman, 2002).

The American model is decidedly different. In contrast to the European systems, the American model relies less on state-provided welfare benefits and more on labor markets and wage flexibility to allocate earnings (Esping-Andersen, 1996). This flexibility is largely credited with incubating the “employment miracle” of the 1990s, allowing companies to create new jobs as well as enabling them to respond with agility to changing economic conditions via wage adjustments and hiring and firing workers. While this strategy is beneficial for companies and the highest-skilled workers, the immediate cost of such a market-based employment strategy has been greater economic uncertainty and inequality for low-skilled or redundant workers.

But forced choice between the welfare regimes of Europe and the market-based American model presents a false set of alternatives. Choices between efficiency and equity, flexibility and security, and private and public provision are not a zero-sum game. Implementing social protection programs may not impede labor market flexibility if countries with extensive social protection systems find other ways to adjust. The effect of intermediaries on economic flexibility also depends on the balance between the provision of equal and economic protections and services that promote adjustment such as education, training, job search, and benefits portability. Or perhaps in markets already distorted by taxes, regulation, and transfer programs, social programs can serve to offset some of these distortions with little impact on the flexibility of mainstream institutions (Blank, 1994). Moreover, in the market-based systems, workforce intermediaries can benefit recipients outside the mainstream but have little effect on the mainstream institutional bias in favor of market-based flexibility.

The Changing Structure of Employment, Education, and Earnings

Early in this country’s history and, in fact, pretty much through our first 200 years, a job was easy to find—especially an entry-level, low-skilled job. Throughout our history, the American dream and the American reality have been that people could start at the bottom and, without much formal education, work their way to the top. But in the last 40 years, globalization in product and capital markets, coupled with a technological revolution, prompted profound changes in the American economy making education, more than work effort, the lever of opportunity.

The concentration of jobs in the United States today is radically different than it was in 1959 (Carnevale, 1999; Carnevale and Rose, 1998). In the new economy, the number of high-

paying, blue-collar jobs available to workers with high school diplomas is shrinking, largely as a result of productivity improvements. The shares of factory and natural resource jobs, such as farming and mining, have each declined by at least one-half—factory jobs declined from 32 to 17 percent of all jobs between 1959 and 2000, and natural resource jobs declined from 5 to 1.5 percent over the same period. And farm and factory jobs have not only lost employment shares, but have suffered actual job losses. The share of jobs in low-skilled services has remained relatively stable at roughly 20 percent.

New job creation has been concentrated in “knowledge jobs” rather than production jobs or natural resource jobs. Tracking the share of total employment shows that jobs in hospitals and classrooms have grown substantially, to 15 percent of all jobs, but white-collar office employment has grown the most—accounting for almost 40 percent of all jobs in 2000. The overall number and share of technology jobs also has grown, but they still do not represent a large share of all jobs (7 percent).

The recent increase in educational requirements on the job is also remarkable. In 1973, nearly one-third of prime-age workers (age 30 to 59) were high school dropouts and another 40 percent had graduated from high school but did not attend a postsecondary institution. In 2000, fewer than one in ten workers were high school dropouts, while about one-third terminated their education with a high school diploma.

In general, educational upgrading has occurred across all occupational groups. While the fastest-growing occupations—those in offices, classrooms, health care, and technology—were always high skilled, they now employ significantly larger shares of educated workers. Generally, at least three-quarters of workers in these fast-growing occupations have completed some postsecondary education. At the same time, workers in service, factory, and natural resource jobs have also become relatively more skilled, although a majority of workers still only have a high school diploma or less.

Coincident with the shift from a high-wage, low-education goods-producing economy to a high-skilled, high-wage service economy is an increase in earnings inequality. Beginning in the late 1970s and continuing through the 1980s, the earnings of the highest-paid 30 percent of workers increased, while the earnings of the bottom 70 percent either held stable or declined. Inequality persisted (but did not grow) throughout the early 1990s. Only in 1995 did the increases in inequality begin to narrow slightly, prompted by decreasing inequality in the bottom

half of the earnings distributions. The top half of the distribution continued to experience a widening in wage inequality (Mishel, Bernstein, and Schmitt, 1999).

Much of the increase in earnings inequality is reflected in education. Those workers with the most education have experienced the greatest earnings gains, while among the least educated, women have experienced less robust gains and their male counterparts have suffered actual declines in their inflation-adjusted earnings. As a result, the earnings disadvantage associated with low-skilled jobs had been rising until the mid-1990s when less educated workers did experience a real gain in earnings. The college-wage premium—the earnings advantage of college-educated workers over high school graduates—in 1979 was 36 percent for men and 34 percent for women. By 1999 however, the premium rose to 76 and 72 percent for men and women, respectively (Mishel, Bernstein, and Schmitt, 2000). The college wage premium rose even though the supply of college-educated workers increased by 60 percent over the period. Even after controlling for other factors that affect wages, the college/high school wage premium for men more than doubled between 1979 and 1999 from 20 to 42 percent, while the premium for women increased from 27 to 48 percent (Mishel, Bernstein, and Schmitt, 2000).

Because earnings are strongly associated with occupation and education, better job matching and investments in education and training are powerful strategies for assisting workers. But using only these mechanisms to assist workers may be a myopic solution that excludes other potential avenues for redress.

Institutions and Economic Change

Changes in institutions and policies brought about by globalization and changing economic relationships, while beneficial for the economy, business, and skilled workers, have left the least advantaged in an increasingly precarious position. Significant reversals in these changes or policies are unlikely, and perhaps appropriately so, to the extent they foster economic growth and more flexible and efficient resource allocation. But those workers left behind need social and economic supports, including workforce intermediaries, greater than ever before.

Skill-biased technological change has often been the favored explanation for the increase in earnings inequality that began in the late 1970s (Cappelli, 1993 and 1996; Katz and Murphy, 1992; Levy and Murnane, 1992; Murphy and Welch, 1993). Technology and earnings are inextricably linked. For example, workers who use computers on the job earn 15 to 25 percent

more than workers who do not (Freeman, 2002; Krueger, 1993; Mishel and Bernstein, 1995). In addition, the effects of technology changes have favored high-wage workers. Their principal effect has been to increase the earnings of the managers and service professionals who deploy and use them, not the technical workers who make and repair them (Carnevale and Rose, 2000). But at the same time, a substantial share of earnings differences between high school and college-educated workers appears to result from declining labor power and public policy, including the decline in the value of the minimum wage and public income transfers, deindustrialization, and the falloff in union membership (Card and DiNardo, 2002; Mishel, Bernstein, and Schmitt, 2000).

The growing economic inequality that occurred in the 1980s was accompanied by a profound decrease in the inflation-adjusted value of the minimum wage. Legislated increases in the early 1990s still did not bring it up to earlier levels. The decline in the real value of the minimum wage hurt the lowest-paid workers, particularly women and explains a majority of the wage dispersion at the lower end of the earnings distribution (Card and DiNardo, 2002; Lee, 1999).

Although the devaluation of the minimum wage may have contributed to the increase in inequality, it is not clear that simply raising the minimum wage will provide the lowest-paid workers with a substantial increase in their standard of living. Estimates suggest that even a raise of \$1.90 an hour would propel fewer than one in seven one-parent families out of poverty and have little impact on those low-income families above 200 percent of the poverty level (Acs, Phillips, and McKenzie, 2001). Using workforce intermediaries to help these workers obtain jobs that allow them to work more hours may prove a more effective strategy in propelling these workers out of poverty (Acs, Phillips, and McKenzie, 2001).

Many low-wage workers in today's economy are impacted by the increased globalization of markets because globalization results in trade that eliminates low-skilled, highly paid jobs and creates global competition among low-wage workers. Jobs lost to trade tend to be low-wage, low-skilled jobs. Jobs gained from trade tend to be more highly skilled and highly paid, both in manufacturing and in the economy on the whole. Some estimates suggest that trade accounts for as much as 30 percent of the increase in wage disparities since the 1970s (Mishel, Bernstein, and Schmitt, 2000). Ultimately, trade affects wages more than the number of jobs. For instance, there were 20 million fewer factory jobs in 2000 than would have existed had the 1959 share of

employment continued. Nevertheless, probably only about 3 million of those jobs were actually lost to trade, the other 17 million were lost to productivity improvements that substituted fewer highly skilled workers for many low-skilled workers. Trade tends to increase the relative earnings of skilled workers in manufacturing and in the economy on the whole but, at the same time, drives down the earnings of low-skilled labor. So while trade can have positive effects on economic growth by promoting a more efficient use of human and capital resources, not all workers benefit. The least advantaged workers are those most likely to suffer the downside of trade.

Wage stagnation and job declines in manufacturing have been exacerbated by an accompanying decline in unionization. Throughout the 1980s, union density declined by 1 percentage point a year, from 25 percent in 1978 to 16 percent in 1989 (Freeman, 1993). In addition to the direct wage effects from declining union membership, deunionization introduces a ripple effect because non-union employers face less pressure to raise wages. As a result, about 15 to 20 percent of the increase in male earnings inequality are attributed to the decline in unionization and its associated effects (Card, 1998; DiNardo, Fortin, and Lemieux, 1996; Freeman, 1993). However, deunionization has little effect on the rising earnings inequality among women, primarily because the share of women belonging to unions has remained relatively constant.

Changing Employment Relationships

The profound economic changes that have occurred in recent years have been accompanied by distinct changes in employment relationships that have created a vacuum between workers and employers that needs to be filled by more effective workforce intermediation. In many respects, employment has become more tenuous. Temporary help and contingent work are more prevalent and allow the labor market to operate more efficiently, but they also create a need for institutions that mediate between workers and employers. At the same time, there has been a decline in job attachment, with workers having less job stability and job security creating a need for reemployment services (See Osterman, Chapter XX).

Today's shift away from internal labor markets and toward more market-oriented systems is not a new relationship between employers and workers. In fact, throughout the 19th and early 20th centuries, employers routinely relied on contingent workers. Like the writing, editing,

payroll, and web design services contracted out in many companies today, in the 18th century, employers routinely used off-site contract workers to manufacture and handcraft products like shoes and clothing. While this increased flexibility and reduced plant and equipment costs, problems with quality control and reliability prompted many companies to bring the contractors on-site by the late 1800s. As companies learned how to set up and manage the functions of the inside contractors, they eventually replaced them by hiring their own, less costly, employees. But it wasn't until the introduction of the assembly line, specialized training for line jobs, and associated management practices that internal labor markets were fully formed (Blair and Kochan, 2000; Cappelli, 2000).

After more than a half century of corporatist employment policies, by the 1980s employers again began contracting out whole functions as well as individual jobs. Globalization, flexible information technology, and financial streamlining all prompted employers to revert to a more market-based system. Looking back, we may see the period of “roughly the 1930s through the 1980s as a temporary departure from the more robust forms of market-mediated relationships” (Cappelli, 2000).

In some respects, the new sense of job insecurity stems from a change in expectations. In the 1950s, relatively few workers looked forward to lifetime employment with health and retirement benefits. At the same time, most workers thought that lifetime security was expanding from union and government workers to eventually include a larger share of the workforce. Moreover, workers associated higher skills with job security. Since the 1970s, expectations of expanding lifetime employment have virtually disappeared in spite of the fact that education levels have risen (Kochan, 2000; Reich, 2001).

Economic Mobility

Declining job tenure is troubling when it results in declining incomes, but changing jobs can be a happy experience when the next job pays more. Job instability and income inequality become less critical if workers can still count on economic mobility to eventually propel themselves upward into the middle class and beyond. In other words, “If income mobility were very high, the degree of inequality in any given year would be unimportant . . .” (Krugman, 1992).

Because of our reliance on upward mobility, principally through a meritocratic education system, we have higher tolerances for disparities in economic outcomes. Americans support equality of individual opportunity, not equal outcomes. Income differences are tolerated because of a widespread belief that there is substantial income mobility, especially through education and subsequent work effort.

The evidence suggests that most workers do experience significant economic mobility. Studies of changes in relative mobility in show that over the long term, roughly 60 percent of low-wage workers and their families moved into a higher income quintile. But there exists a minority of low-earning workers and families who do not move up the income distribution, and many of those who do move up do not make it very far. Of those workers in the bottom quintile, between one-fifth to one-third were upwardly mobile in one year, and 40 to 47 percent moved out of the lowest quintile within about a decade (Burkhauser, Holtz-Eakin, and Rhody, 1997; Gottschalk, 1997; Gittleman and Joyce, 1995; Mishel, Bernstein, and Schmitt, 2000; Sawhill and McMurrer, 1996). Of the nearly 60 percent who moved up over 25 years, one-quarter moved into the second income quintile, 16 percent moved into the middle quintile, 12 percent moved into the second highest quintile, while only about 6 percent reached the highest quintile (Mishel, Bernstein, and Schmitt, 2000).

Significant year-to-year fluctuations are apparent in income measures. Averaging income over three years to smooth out the income spikes shows somewhat lower mobility. Across both 10- and 20-year periods, only about 40 percent of families moved out of the bottom quintile. Among those who did move up, about one-quarter moved into the second lowest earnings quintile, roughly 9 percent moved into the middle quintile, but only about 6 percent moved into the top two quintiles combined (Mishel, Bernstein, and Schmitt, 2000).

Low-earning workers are also more likely to leave the labor force than are other workers. Roughly 15 percent of low-earners leave the labor force within 5 years, compared with fewer than 10 percent of higher earning workers (Carnevale and Rose, 2001b). Of those low-wage workers employed full-time, 4 in 10 were either working part-time or not at all 5 years later (OECD, 1997). Low-paid women were much more likely than low-paid men to leave the labor force or reduce their hours. And among those workers who remained in the labor force, men were much more likely to move up than women—while nearly one-half of male workers transitioned out of the lowest earnings group within one year, only 28 percent of women moved

up. Disparities in the economic mobility of men and women persist overtime; even after 10- and 15-year intervals only one-half of women advanced into a better economic position, while three-quarters of men advanced (Carnevale and Rose, 2001b).

The balance of the literature suggests that income mobility has remained relatively stable over time. And while the United States promotes its economic flexibility and mobility as providing opportunity, income mobility appears to be similar across countries (Aaberge et al., 2000; Burkhauser, Holtz-Eakin, and Rhody, 1997; Sawhill and McMurrer, 1996).

The Demographic Twist

Although future economic realities favor higher levels of education and a broader array of skills, a reversal in longstanding demographic trends may make it difficult to fulfill these needs without increasing investments in labor market intermediation. The most powerful of these trends is the retirement of the baby boom. These boomers are working today but they will age beyond 55 years from here on out, prompting a rapid depletion of workers from the American labor force over the next 20 years. The depletion of workers is expected to be especially strong among the most experienced and highly educated workers because it is those baby boomers that have the greatest access to retirement income that supplements social security. By 2020 there will be about 46 million baby boomers with at least some college who will be over 55 years of age (Carnevale and Fry, 2001).

While successive generations have acquired more schooling, educational attainment has plateaued among American youth over the last several years in spite of a doubling in the college/high school wage premium since the early 1980s. Between 1980 and 2000, the share of workers with at least some college increased by 20 percentage points. If current rates of college going persist, the share of Americans with at least some postsecondary education or training will only increase by 4 percentage points between 2000 and 2020 (Aspen Institute, 2002). Moreover, the recent collapse of public budgets at a time when 4 million additional 18- to 24-year-olds are moving into their critical college-going years suggests that rates of postsecondary educational attainment will remain flat or decline.

Baby boom retirements and flat educational attainment rates are especially troublesome in the context of broader demographic and employment trends. The U.S. workforce, whose size has increased by almost 50 percent over the past 20 years, or roughly 39 million workers, will

slow its growth to only 16 percent over the next several decades (Ellwood, 2001). Assuming even moderate employment growth rates of 15 percent and a continuing increase in skill requirements on the job, the combined effects of these trends should result in significant labor shortages of at least 20 million workers, especially in jobs that require the most skill and provide the greatest economic value added. Two-thirds of the expected shortage in 2020 will likely arise in the most skilled jobs, resulting in a net deficit of workers with at least some college of about 14 million workers.

In the face of sharply reduced labor force growth rates and possible skill shortages, education and training policies will have to play the lead role. In addition, family supports will be necessary to maintain or increase labor market participation, especially among women. Higher minimum wages, more flexible benefits, and an expanded Earned Income Tax Credit (EITC) also may be necessary to encourage labor force participation. We know that a plethora of policies underlying the social safety net has effects on individuals' decisions to work. While lowering the social safety net even further might increase the size of the labor force, only expensive and politically difficult policy changes are likely to increase the available numbers of highly skilled workers (Ellwood, 2001).

Increasing retirement ages, for instance, will sustain labor force participation most among those most dependent on social security payments for retirement. These tend to be the lowest paid and least skilled workers. Further increases in the labor force participation of married women by expanding child care assistance to the middle class may be the best bet for bringing more skilled workers, but would be extremely expensive (Ellwood, 2001). Large-scale, skill-based immigration policies would be effective but politically sensitive.

Size of the Problem

Make no mistake, expanding a labor market mediation system to reach a labor force of 140 million people will be a costly and complex undertaking. Even reaching out only to low-wage workers will require a sizable increase in investments. While welfare reforms in the mid-1990s were aimed at about 4.5 million adults, the size of the low-wage population earning less than \$15,000 is more than ten times as large at 46.2 million, or about one-third of the labor force. The core of the low-wage labor force is somewhat smaller with fewer than one-half of those workers (20.2 million) residing in low-income families earning less than \$25,000 a year. Fewer

yet are the 15.6 million workers—or one-third of all low-earners—who are significant contributors to total family income (Carnevale and Rose, 2001a). But still, this workforce is nearly three and one-half times larger than the adult welfare population when the rolls were bulging.

In addition to the sheer size of just the low-wage population, there are inherent barriers that compound the problem. While alleviating macro-economic and institutional barriers and increasing job matching and attachment assistance may help workers access better jobs, many workers still have formidable skill barriers that prevent them from moving up the earnings ladder. Unlike creating innovative child care, transportation, or housing solutions, skill problems are not always quickly resolved. About 15 percent of the labor force (22 million) are only minimally adept at performing everyday work- and life-related skills and cannot, for instance, calculate postage costs or interpret instructions from an appliance warranty (Carnevale and Desrochers, 2002).

Education and training programs already in place and targeted to assist these lowest-skilled workers serve only a fraction of the roughly 20 million low-wage or minimally [adept](#) workers. For example, the former Job Training Partnership Act (JTPA) programs titles I, II, and III only served about 550,000 people a year, while Adult Education Programs serve about 4 million people a year.

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Expanding education and training programs to improve the skills of all low-wage workers will be costly. For many of these workers, the investment will be well spent, and providing access to the “first-chance” education system is likely to have the greatest long-lasting effects. But for those who need years of basic education or training to meet the minimum expected skill levels in better than low-wage jobs, the costs may exceed the public’s willingness to pay. Better access to “second-chance” social and income supports may be a more cost-effective and politically acceptable alternative.

Flexibility and Scale Are Not Enough to Guarantee Our Competitive Position

In the future, our ability to produce high levels of skill will be critical to the overall performance of the American economy in global competition. Currently, as in the past, our global competitiveness relies less on the quality of our human capital and more on the size of our labor force and the flexible ways we use our human capital. In the future, the general scarcity of

labor in America, especially skilled labor, may force us to change our global strategy. Moreover, many of our competitors already have a superior quality of human capital and their advantages may be increasing. For instance, already Great Britain and three other European nations have higher college graduation rates than the United States (OECD, 2001). In addition, our competitors are rapidly learning to compensate for the U.S. advantages in flexibility and scale by reducing rigidity in their systems of labor market mediation and by creating multinational trading blocs such as the European Communities (EC) and the Asia-Pacific Economic Cooperation (APEC).

Our historical reliance on flexibility and scale, more than human capital development in global competition, is evident in the apparent disconnect between our global economic and educational rankings. For instance, our scores on international tests are consistently sub-par. When compared to other developed nations, the United States ranks in the middle on international measures of skill. Although the United States tends to have a larger share of high-skilled workers than most other countries, it also harbors a larger share of low-skilled workers (OECD, 2000). And while American educational performance is improving at home, among youth aged 25 to 34 who have a high school diploma, we have quietly dropped to sixth in the world behind Norway, Japan, Korea, Czech Republic, and Switzerland (OECD, 2001).

How can we reconcile our mediocre skill assessment and educational attainment standings in the world and our economic success in the high-tech global economy? The answer is that we may not have, on average, the world's *best* stock of skills, but we are pretty good and, because of our size, we have *more top workers*. For instance, our population is roughly four times the size of that of France, Italy, and the United Kingdom, and more than three times the size of Germany. So while the United States and Germany have similar shares of high-skilled workers, the sheer size of the U.S. labor force translates into roughly 38 million highly skilled U.S. workers, as compared to 11 million German workers.

More is not always better. But oftentimes, four pretty good engineers tackling a business problem is better than one very good engineer working alone addressing the same issue. Similarly, four companies in the software business competing directly against each other are likely to produce better software than a single company.

A second advantage that allows us to be the number one economy with a mediocre educational performance is our flexibility (Bertola, Blau, and Kahn, 2001). Flexible U.S. labor

markets allow employers enormous agility in hiring, paying, and allocating workers. America's agility gives us an edge in the global race because it allows us to make better use of our talent.

In Europe and Japan, by comparison, access to jobs and pay is highly regulated by skill certification and seniority, which contributes to job security and income security as well as structural rigidity. European and Japanese education and labor market systems have a tough time redesigning jobs or shifting human and machine capital investments in response to economic and technological change. In recent years, the equitable but inflexible European and Japanese models have driven up costs, suppressing job creation and driving up unemployment. In contrast, the agile American model has boosted job creation *and* income inequality.

America's characteristic flexibility also means that employers don't need to rely on the nation's homegrown talent. Immigration is a major source of talent among math and science professionals. For instance, a majority of America's civil engineers are foreign born and more than a third of all engineers are foreign born (National Science Foundation, 2002). In addition, American companies are free to produce offshore if they cannot find the talent at home at the right prices.

The problem is that our advantages won't last. We cannot remain a first-rate economic power with mediocre human capital. All forms of advantages are temporary in global economies. The European and Japanese versions of highly planned economies surged in the 1970s but lost out to American flexibility in the 1980s. Eventually, our competitors will narrow our economic lead as they learn how to create their own versions of agility and scale. At that point, the competition will really come down to who has the best human capital—especially in a world where people are no longer nation bound and technology and financial capital ignore national boundaries as they hop across borders from one entrepreneurial opportunity to the next.

At some point soon, if we are to retain the lead in the global economic race, we will have to rely on our homegrown human capital and a more cohesive system of labor market mediation for our competitive edge. Eventually, we will have to close the education gap between our competition and ourselves.

Conclusion

Shortages of both skilled and unskilled labor, as well as increases in earnings dispersion, should increase support for workforce intermediaries both in scale and in the scope of services

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they provide. Whether or not these forces will provide sufficient pressure to break down the current dualism in the structure of mediating institutions and labor markets remains to be seen.

A scarcity of labor, resulting from the combined effects of baby-boom retirements and a flattening of labor force participation and educational attainment, is likely to generate a variety of responses. Scarcity should increase labor power, unionization, and the political viability of proposals to “make work pay” in order to encourage labor force participation and to promote flexibility. The need to sustain female participation should increase political leverage for family support services such as child care and after school programs. Shortages in skilled labor also will increase support for education and training both in the “first-chance” and “second-chance” systems. Scarcity should create support for using workforce intermediaries to access these and other services such as health care. Of course, cost will be a barrier to expansion, and public budget austerity will increase pressures for accountability throughout intermediary institutions.

Alternate proposals such as increased immigration, including an increase in skill-based immigration, will be supported by employers, but will run afoul of populist political responses. Increased imports and offshore production to satisfy domestic consumer demand have similar political liabilities because offshore strategies increase trade deficits and export wealth and jobs. Global strategies could be especially sensitive if labor scarcities result in the exportation of high-wage, high-skilled jobs.

Encouraging policies that stall retirements will only affect the lowest-paid, lowest-skilled workers and provide little relief for shortages in skilled occupations. Economic incentives to keep baby boomers on the job will be expensive because skilled workers over 55 years of age have high expectations for earnings, public and private benefits, and flexible work schemes.

In the short term, the American system of mediation among individuals, communities, and labor markets is likely to remain market based, privatized and divided into “first-chance” and “second-chance” tracks. First of all, the market-based and privatized system, already in place, benefits the most advantaged who are not likely to be willing to dilute its benefits—the national health care debate is a case in point. To some extent, emerging labor shortages will encourage “cherry picking” and the most skilled among the disadvantaged population should be able to transition from the “second-chance” to the “first-chance” system. At the same time, austerity in public budgets will discourage more extensive investments in the least skilled,

leaving “work first” combined with strategies to “make low-skilled work pay” as the likely path of policy development.

In the long term, the core strategy for developing skilled workers and reducing our runaway income inequality is through inclusion in the “first-chance” mainstream educational system. In the meantime, expanding social and economic inclusion beyond access to working poverty and dead-end jobs requires that we dramatically increase the scale and scope of the income and social supports in the “second-chance” system. At a minimum, mediating services that support working families need to include expanded access to include health care, day care, and after school programs. In order to “make work pay,” substantial increases in the minimum wage need to be accompanied by an expansion in the EITC. In order to encourage economic mobility, education and training should be generally available and supported by family services and stipends that assist people who are in school and out of work.

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