An early spring looks in store for workers with unexpected good news from the U.S. Labor Department: In January, unemployment clocked in at 5.7%, down from a post-financial crisis high of 10% in October 2009. Over the last three months, employers hired at the fastest pace since 1997. Another positive sign: After years of stagnant wage growth, average hourly earnings rose by 0.5%, the biggest gain in six years.

Though small, this uptick in wage growth raises the question of whether economic recovery might finally bring higher pay along with it. In February, Wal-Mart Stores announced a pay raise for its U.S. workers to $10 an hour, above the $7.25 an hour federal minimum wage, and other companies, such as Starbucks, Panera Bread Co. and Aetna have also raised wages at the lower rungs. That’s good news, when average real wage growth has hovered around zero among developed countries since the end of the financial crisis, according to a 2014 report by the Organisation for Economic Co-operation and Development, the International Labor Organization and the World Bank Group. G-20 countries overall have averaged only 1% to 2% real wage growth a year, most due to wage increases in China, according to the report.

Workers should remain skeptical of any dramatic change afoot on the wage front, however. The economic recovery taking hold at least in the U.S., if not in other major developed economies, may enable workers to claw back jobs, but dramatically higher pay is a much more tenuous prospect. The availability of still more U.S. workers on the sidelines ready for hire, along with an eager supply outside the U.S., continued displacement of workers via technology, and weaker worker protections in the law will allow employers to hold the upper hand for some time to come, experts say.

Hold the Champagne
For these reasons, “in the near term, we can expect to see moderate levels of real wage growth” in the U.S., predicts Seth Harris, former deputy labor secretary in the Obama administration and distinguished scholar at Cornell University’s School of Industrial & Labor Relations. “It’s nothing to pop champagne corks over, not the least because most workers can’t afford champagne. We need to see larger real wage growth over a much more extended period of time across all wage levels in the economy before we say we’re making progress.”

Current wage growth “is nothing to pop champagne corks over, not the least because most workers can’t afford champagne.” –Seth Harris

The problem: Despite recent declines in unemployment, “there is still a lot of labor slack, and so it is easier and more efficient for firms to employ new workers at the current wage rate,” says Kent Smetters, Wharton professor of business economics and public policy.

Dean Baker, co-director of the Center for Economic and Policy Research, a think tank in Washington, D.C., agrees: “We’re still down four to five million jobs [compared to before the recession]. [The number of] people working part-time is up some 50% from pre-recession times, and very few are voluntarily quitting their jobs. Workers don’t feel secure, and they are not in a position to see substantial wage gains.”

Indeed, today’s 5.7% unemployment rate is still quite a bit above the low 4% rate in the late 1990s, the only period of dramatic wage growth at all income levels since the late 1970s. The reason for the gains: Very tight labor markets, due to supply and demand, or few workers compared to a large number of jobs in those go-go economic times. The era was characterized by extremely low unemployment and non-employment, or people not counted in unemployment who are not working but still able to work, Harris says. Today, the labor force participation rate is at its lowest level since 1978.

Dividing the Pie

Despite that one bright moment in the late 1990s, U.S. real average hourly wages haven’t budged much for decades. The U.S. average hourly wage of $20.80 in January 2015 is about the same as that in January 1973, adjusted for inflation, according to the Bureau of Labor Statistics.

Clearly, longer-term issues than economic cycles are affecting wage growth. “The big change over the past couple of decades and especially since The Great Recession has been the shift in how the [economic] pie has been divided,” says Peter Cappelli, professor of management and director of the Center for Human Resources at Wharton. “Customers are getting a good deal of it [with] much better products and services, if not always at lower prices, than with increases that aren’t very big. Shareholders have been doing well with a booming stock market. But employees have been doing poorly.”

“Shareholders have been doing well with a booming stock market. But employees have been doing poorly.” –Peter Cappelli

The consequence: Rising inequality. In his 2014 book, Capital in the Twenty-First Century, French economist Thomas Piketty noted famously that the top 10% of U.S. earners now gets 40% to 45% of national income, up from 30% to 35% in the 1970s, while the bottom half gets only a quarter of national income.

What’s more, most of the gains for the top 10% in the U.S. have taken place among the 1% at the pinnacle, according to Piketty. The top 1% received three-fourths of the wage gains of the top 10%, while the other 9% saw pay increases just slightly above those of average workers in lower income tiers, he writes. Piketty attributes the outsized gains at
the pinnacle to the rise of “super-managers,” or elite corporate executives who are able to negotiate very high levels of compensation.

Meanwhile, as the top ate more of the pie, the U.S. middle class, defined in this instance as households with incomes from $35,000 to $100,000, shrank, as more of them fell to lower incomes. In the late 1960s, more than half of U.S. households were in the middle class; today, only about 40% are in that category, according to the New York Times.

**New Rules**

These phenomena call into question previous ideas in economics. “Increasing productivity does not necessarily lead to higher wages for the average worker,” says Janice Bellace, Wharton professor of legal studies and business ethics. “Something else has to happen for the gains to be distributed evenly.” Since 2010, productivity across G20 countries started rising from the recession slump, but wages stayed stagnant, according to the OECD report. Indeed, says Capelli, “productivity increases don’t have to be shared with labor. Who gets it all depends who has the bargaining power, and labor hasn’t had it.”

In his book, Piketty takes a shot at the late Nobel Prize-winning economist and former Wharton professor Simon Kuznets and the so-called Kuznets curve for predicting a rise in inequality at early stages of an economy’s development and then a decline as economies grow. But in a recent article, Sangheon Lee, special advisor to the deputy director for policy of the International Labour Office, points out that Kuznets did not believe inequality would decline automatically as a law of economics, but rather as a result of political choice, as lower-income urban workers gain more power.

> “Increasing productivity does not necessarily lead to higher wages for the average worker.” — Janice Bellace

Over the last four decades, political choices, combined with global economic trends, have worked in the opposite direction to undermine workers’ leverage. Unions are in decline, the minimum wage has eroded in value, and both globalization and technology are replacing U.S. workers. “Our trade policy deliberately put manufacturing workers in direct competition with low paid workers in the developing world, with the predicted effect of lowering their wages,” says Baker of the Center for Economic and Policy Research.

Indeed, says Bellace, many developments coincided to hand employers the bargaining chips. In the 1970s, rising oil prices put pressure on producers to control other costs, such as wages, rather than raise prices, she notes. And the entry of baby boomers and women into the workforce helped keep wages down in that era. Over the next several decades, with the rise of globalization, companies outsourced operations to lower-wage countries. Meanwhile, technological innovation eliminated many jobs, and “new tech companies typically create few jobs compared to manufacturing companies,” she adds.

**What Next?**

Restoring the America dream for the middle class is set to take center stage in the upcoming Presidential election in both parties. Politicians and policymakers will be debating a variety of ideas. They include returning minimum wage hikes, more overtime protections, giving free choice to workers to join unions, and alternative forms of worker organizations, such as immigrant workers’ centers. Government financial support for higher education, including free community college education, as President Obama discussed in his State of the Union Address, could also raise workers’ prospects. In addition, federal funding putting Americans to work rebuilding the nation’s aging infrastructure would address multiple needs, says Wharton’s Smetters.

But, “nothing raises wages like very low unemployment,” says Harris. To that end, the U.S. Federal Reserve Board has a tough decision to make later this year on when to start raising interest rates again to head off inflation as the
economy takes off again. Bets are on that with continued declines in unemployment, the Fed will start raising rates in mid-year. But, says Wharton’s Capelli, stubbornly sticky wages may mean the Fed should consider conducting its monetary policy differently now. In the absence of easy wage gains, he says, “the economy could run hotter without concerns about inflation. So there are fewer concerns about the need to moderate expansionary monetary policy.”