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## Income Inequality in the Digital Era

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**Katherine V.W. Stone**

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\* This piece is part of the author's forthcoming book, KATHERINE V.W. STONE, WORK IN THE DIGITAL ERA: LABOR AND EMPLOYMENT REGULATION FOR THE CHANGING WORKPLACE (2003). All rights reserved

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In the past decade, there have been changes in the workplace as momentous as those that occurred at the turn of the last century when artisan production gave way to industrial era production systems. Guided by the postulates of scientific management and personnel management, early 20<sup>th</sup> century industrialists repudiated the labor relations systems of the past and constructed a new labor relations system in its place. They erected a system of industrial practices comprised of job ladders, internal promotion schemes, seniority, welfare benefits, and inducements for long-term employment -- a system known as an internal labor market -- that has dominated major U.S. firms throughout the 20<sup>th</sup> century. At the end of the 20<sup>th</sup> century, the internal labor market job structures themselves began to dissipate. Employers, faced with increased competition in the product market and technological change in production methods, began to seek more efficient and effective ways to organize the workplace. They sought flexibility rather than stability in their work force. Out of their efforts have emerged a new constellation of features that are increasingly defining the new digital era workplace-- an explicit rejection of job security combined with promises of training and opportunities for human capital development, a flattening of hierarchy, opportunities for lateral movement within and between firms, market-based pay with steep performance incentives, opportunities to network with firm constituencies, an emphasis on quality and customer satisfaction at all levels, and plant-specific dispute resolution mechanisms to foster and preserve a perception of fairness. Taken together, these features mean that attachment between the employee and the employer has been severed, and employees now operate in a boundaryless workplace.<sup>1</sup>

The new employment system promises both freedom and vulnerability to the working population. For some, it signifies an escape from the rigid hierarchies of the past, hierarchies that were often racially or gender biased in their operation. It also promises to free many from the mind-numbing narrowness of work tasks that were required by the precisely defined job classifications of the past. Yet the new system also creates great vulnerability. It shifts many of the risks of the employment relationship from the firm to the individual. Gone is the individual job security and reliable income and benefits of the past. Individuals must manage their careers, market their talents, and take their compensation as the market measures their value. The new workplace also generates serious concerns about workplace fairness and social justice. Elsewhere I have documented the ways in which the changing work practices

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<sup>1</sup> Katherine V.W. Stone, *The New Psychological Contract: Implications of the Changing Workplace for Labor and Employment Regulation*, 48 UCLA Law Rev. 519 (2001).

generate new forms of discrimination that are difficult to eradicate, new dangers for employees to forfeit their own human capital and intellectual property, new difficulties for union organizing, and new impediments to collective representation and voice.<sup>2</sup> In this paper I discuss the impact of the changing workplace on income distribution.

The changes in the employment relationship have been accompanied by a marked deterioration in income distribution. The U.S. income distribution has become considerably more unequal since 1970, a trend that accelerated in the 1980s and 1990s. The growing gap between rich and poor stands as a persistent reminder that current economic arrangements are not moving in the direction of economic justice. The dramatic extent of inequality offends our sense of decency and undermines social cohesion. In recent years, many economists have analyzed the trends in income distribution in order to isolate the causes of the current trends. In this paper I review the existing evidence and theories about the causes of rising income inequality. I suggest that the changing nature of the employment relationship is contributing to, or perhaps even driving, rising income inequality. The following chapter presents and evaluates several policy proposals for redressing inequality or ameliorating its effects.

## **A. The Causes of Rising Income Inequality**

### ***A.1 What Really Happened?***

While there are many ways to measure income inequality, all measures tell the same story: There has been an increase in income inequality in the United States since 1970 and a particularly sharp increase in the late-1980s and mid-1990s. For example, the share of total income going to those in the highest ten percent of the income distribution -- called the top decile -- increased from under 32 per cent in 1970 to nearly 42 per cent in 1998. Of this, the lion's share of the increase went to those in the very top. The share of total income going to the highest one per cent of the population has more than doubled between 1970 and 1998, from 5 per cent to 11 per 1998. And the share going to the top 0.1 per cent more than tripled in that period, rising from under 2 per cent to 6 per cent.<sup>3</sup>

Since the late 1970s, only those with incomes in the highest 7 or 8

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<sup>2</sup> Id.

<sup>3</sup> Thomas Piketty and Emmanuel Saez, *Income Inequality in the United States, 1913 - 1998*, NBER Working Paper 8467, Figure 1 (September, 2001).

percent have seen increases in their hourly pay.<sup>4</sup> The income of wage-earners in all other groups experienced declines. The share of income going to the bottom 20 per cent -- the bottom quintile-- has declined most severely. The attached Table shows that between 1979 and 1999, the incomes of those in the bottom quintile declined in absolute terms by 9 percent, shrinking from 5.7 per cent of total income to 4.2 per cent. In the same period, the share of total income going to the middle quintile declined from 16.4 per cent to 14.7 per cent, while those in the highest quintile grew from 44.2 percent to 50.4 percent. According to the Center for Budget Priorities, "In 1999, for the first time in the years CBO has examined, the top fifth of the population is expected to receive slightly more after-tax income than the rest of the population combined."<sup>5</sup>

[insert Table]

One measure of inequality economists use is to compare the income of those in the top ten percent of the income distribution with those in the lowest ten percent, a number known as the 90/10 ratio. Between 1970 and 1998, the 90/10 ration for men increased from 3.85 to 5.31, and for women increased from 3.41 to 4.33. This indicates substantial increase in inequality between those at the top and those at the bottom of the income distribution.<sup>6</sup> Or to put it the contrast even more starkly, as of 1999, the share of income of the top one percent, some 2.7 million Americans, is approximately the same as that of the 100 million Americans with the lowest incomes.<sup>7</sup> This dramatic rise at the very top of the income distribution has generated a small group earning mega-salaries, a group known as the "Working Rich."<sup>8</sup>

In addition to comparing the top to the bottom, economists also measure inequality by looking at whether there has been a dispersion or a convergence between the bottom and the middle of the income distribution. To measure growing inequality in the lower part of the income distribution, economists compare the share of total income going to the group in middle, those in the fifty per cent decile, with the share going to the bottom, the ten per cent decile. This comparison, the 50/10

<sup>4</sup> Gary Burtless, Robert Z. Lawrence, Robert E. Litan and Robert J. Shapiro, *GLOBALPHOBIA: CONFRONTING FEARS ABOUT OPEN TRADE* 77-78 (Brookings Institute, 1998).

<sup>5</sup> Isaac Shapiro and Robert Greenstein, *The Widening Income Gulf*, Center on Budget Priorities (September 9, 1999). See also, Frank Levy, *THE NEW DOLLARS AND DREAMS* at 199, Table A.1.

<sup>6</sup> U.S. Census Bureau, Current Population Reports, "The Changing Shape of the Nation's Income Distribution," Table 1, page 3 (June, 2000).

<sup>7</sup> Shapiro and Greenstein, *supra.* at 2. See also, Piketty [check].

<sup>8</sup> Piketty and Saez, at \_\_\_\_ & Figure 4.

ratio has increased in the past thirty years. The 50/10 ratio for men increased from 2.14 to 2.43 between 1970 and 1998, and for women it increased 1.98 to 2.08 in the same period. These numbers reveal that while the income spread between the top and the bottom has also been increasing dramatically, inequality between the middle and the bottom has also been increasing, but not by as much.<sup>9</sup>

Another measure of income inequality is a number known as the gini coefficient. The gini coefficient measures how far a particular distribution of income departs from a distribution of total equality. If income were distributed equally amongst everyone, the gini coefficient would be zero. If income were distributed totally unequally -- i.e., if one person had all the income and everyone else had none -- the gini coefficient would be 1. A gini coefficient of greater than zero indicates the presence of inequality, and the closer the coefficient is to 1, the greater the amount of inequality present. In the U.S., the gini ratio for men has increased from 0.305 to 0.401 between 1970 and 1998; for men and women combined it has increased from 0.326 to 0.393. These are the largest gini ratios of any industrial country.<sup>10</sup> By all these measures, aggregate income inequality in the U.S. has increased dramatically in the past two decades.

Yet another measure of income inequality compares the executive pay levels to those of the average wages or salaried full-time worker. This inquiry reveals that the ratio of top CEO pay to average pay of a full-time worker has widened substantially, particularly since 1980. As recently as 1980, an average CEO of a large American company earned 42 times the earnings of the average worker; twenty years later, in 2000, the same CEOs earned 419 times an average worker's pay.<sup>11</sup> Between 1970 and 1999, the pay of the top-paid 100 CEOs increased by more than 400 per cent while that of the average salaried worker remained flat.<sup>12</sup>

When the income distribution figures are broken down in more detail, two features stand out. First, there has been a dramatic increase in the incomes of the highest earners. Indeed, the higher the income group, the greater the increases. For example, the per cent increases for the top 5 per cent of the income distribution was considerably greater than the increases for those between the 90th and the 95th percentile. Second,

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<sup>9</sup> Piketty, *supra.* at \_\_\_\_.

<sup>10</sup> *Id.*

<sup>11</sup> Robert H. Frank, *Higher Education: The Ultimate Winner-Take-All Market?*, paper on file with author. [check Business Week, April 17, 2000] [There is a similar statistic in Robert Frank, *Luxury Fever* (1999), reporting that in 1973, CEOs of large companies earned 35 times that of the average worker, and in 1999 they earned about 200 times as much. p. 33)

<sup>12</sup> Piketty and Saez, *supra.* at Figure 18.

the returns to education have increased dramatically. Wages of lower skilled workers – those workers with only a high school diploma or less – have declined precipitously in the past three decades, while those with college degrees or higher educational attainment have increased disproportionately. For example, male high school drop-outs experienced a decline of 20.8 per cent in their real median income between 1967 and 1999. Males with a high school diploma but no additional schooling experienced declines of 6.5 per cent. Yet in the same period, males with a college degree or more have seen a rise in their median incomes of 13.4 per cent. Or, to put it differently, a college educated man earned 149.7 percent of what a high school graduate earned in 1967, and 181.4 per cent in 1999.

The change in the education wage premium for women has also been pronounced. In 1967, women who completed college earned 151.1 per cent of women who had only completed high school; by 1999, college-educated women earned 181 per cent of their high school educated peers.<sup>13</sup> Concomitantly, occupational wage differentials have moved in a direction that indicate a rising returns to education. Between 1970 and 1987, incomes of professionals and managers rose considerably while those of clerical, craftsmen, operatives, and laborers fell.<sup>14</sup>

## **A.II The Theories**

### **A.II.1. Skill-Biased Technological Change**

Economists agree about the facts of growing inequality, but they disagree about its cause. Some of the factors cited to explain the phenomenon are the decline of unions, the decline in the minimum wage in real dollars, increased international trade, rising trade deficits, the shift from manufacturing to service sector production, and technological change. Of these, the most frequently cited explanation is that technological advances, particularly the advent of computerized technologies, have created greater demand for higher skilled and more educated workers and diminished demand for less skilled and less educated workers. By means of a simple application of the laws of supply and demand, this theory posits that skill-biased technological change has driven up the wages of the higher skilled and driven down those of the lower skilled.<sup>15</sup>

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<sup>13</sup> Francine D. Blau, Marianne A. Ferber, and Anne E. Winkler, *THE ECONOMICS OF WOMEN, MEN AND WORK* 267-268 (4<sup>th</sup> Ed.) (Prentice-Hall, 2002).

<sup>14</sup> Juhn, Murphy, & Pierce, *Accounting for the Slowdown in Black-White Wage Convergence*, in Marvin H. Koster, *WORKERS AND THEIR WAGES*, 107, 135-139 & Table 4-7.

<sup>15</sup> See, e.g. Frank Levy, *THE NEW DOLLARS AND DREAMS: AMERICAN INCOMES AND ECONOMIC CHANGE*, 86-87 (Russell Sage, New York, 1998); Burtless, et. al., *GLOBAPHOBIA*, supra. at 83-84; .

The skill-biased technological change explanation has become the overwhelmingly dominant explanation for rising income inequality. However, there is a growing chorus of economists who suggest it is not the sole explanation. For example, Thomas Piketty and Emmanuel Saez challenge the skill-biased technological change thesis on the ground that the timing of the shifts in income disparities does not support it. Using IRS data to examine changes in the U.S. income distribution since 1913, Piketty and Saez found that income distribution narrowed during World War I due to wage controls, remained compressed until 1970, and then began to widen steadily. Piketty and Saez contend that widening income disparity cannot be simply a response to technical change or changes in the supply of educated workers, because otherwise inequality would have increased immediately after the wartime wage controls were removed rather than remain compressed until 1970. Similarly, they contend that the huge increase in the incomes of the top since the 1970s is not compatible with the explanation based solely upon the advent of computerized technology because the increase is highly concentrated among the very highest earners. The theory cannot account for the rise of the Working Rich. Piketty and Saez instead posit that changing social norms is an important factor in explaining the recent increase in income inequality, particularly in the rise of mega-incomes for the very top earners. They argue that the redistributive policies of the New Deal period and pressures from labor unions constrained wage inequality in the U.S. from WWII until the mid-1970s. In recent years, those social norms and union pressures have subsided, allowing the incomes of the "Working Rich" to rise.<sup>16</sup>

Economist David Howell also challenges the skill-biased theory on grounds of its timing. Unlike Piketty and Saez, Howell focuses on the bottom of the income distribution rather than the top. He shows that the largest decline in the wages of those at the bottom of the income distribution occurred between 1979 and 1983, a time before there was significant computerization in the workplace. While wage dispersion increased after 1983, the shift away from low skilled labor had already occurred.<sup>17</sup> Like Piketty and Saez, Howell argues that institutional factors explain the collapse of wages for those in the lower 70 percent of the income distribution in the 1980s and 90s. He argues that the ideological shift toward laissez faire markets and the globalization of production ushered in a host of public policies that undermined workers' bargaining

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<sup>16</sup> Thomas Piketty and Emmanuel Saez, *Income Inequality in the United States, 1913 - 1998*, 26-28, NBER Working Paper 8467, (September, 2001).

<sup>17</sup> David R. Howell, *Theory-Drive Facts and the Growth in Earnings Inequality*, 54 Rev. of Rad. Poli. Economics 54, 64-70 (1999).

power. Some of these policies were a decline in the real minimum wage, an increase in legal and illegal immigration, welfare reform, and public and private policies that undermined unions.<sup>18</sup>

Some economists have challenged the skill-based technological change theory on other grounds. For example, some point out that if skill-biased technological change were the *sole* explanation, we would expect to observe similar trends in the income distribution in other countries that experienced similar technological advances during the same period. France and Canada are examples of countries that have production processes akin to the U.S. but have not experienced growing income inequality. In France, for example, the share of total income going to the highest decile declined between 1970 and 1998 from almost 33 per cent to 32 percent, with a dip to 30 percent in the mid 1980s. In Canada, in the 1980s, family inequality, as reflected in the gini coefficient, actually fell. Other countries that experienced the same technological changes have experienced vastly different effects on their national income distributions.<sup>19</sup>

Despite such counter-factual evidence, the international comparison does not entirely refute the skill-biased technological change thesis. After all, each country has its own set of wage setting institutions and traditions that mediate with differing degrees of success whatever effect technological change might have on the income distribution. Thus, it is possible that even with a shift toward higher technology production processes, the impact on a country's income distribution could differ due to differences in institutions and policies that are available to combat the dis-equalizing effects.<sup>20</sup>

Francine Blau and Larry Kahn conducted an exhaustive comparative study of income distribution in Western Europe and concluded that technological change alone does not explain differing experiences with inequality -- that it is also necessary to factor in the differential role of labor laws, unions, and other wage setting institutions.<sup>21</sup> Blau and Kahn's

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<sup>18</sup> David Howell, *Skills and the Wage Collapse*, American Prospect piece.

<sup>19</sup> On income inequality in France, see David R. Howell, *Theory-Driven Facts and the Growth in Earnings Inequality*, 31 RRPE 54, 62-63 (1999); Piketty and Saez, supra. n. \_\_\_\_, \_\_\_\_, & Figure 19. On inequality in Canada, see David Card & Richard B. Freeman, *Small Differences that Matter: Canada vs. The United States*, in Richard B. Freeman, ed., *WORKING UNDER DIFFERENT RULES*, 189, 193 (Russell Sage, 1994). For other cross country comparisons, see Blau and Kahn; Pontesson.

<sup>20</sup> See Richard B. Freeman & Lawrence F. Katz, *Rising Wage Inequality: The United States vs. Other Advanced Countries*, in Freeman, *WORKING UNDER DIFFERENT RULES*, supra., 29, 51-56.

<sup>21</sup> See Francine D. Blau and Lawrence M. Kahn, *US LABOR MARKET PERFORMANCE IN INTERNATIONAL PERSPECTIVE THE ROLE OF LABOR MARKET INSTITUTIONS* (New York, Russell Sage

findings are consistent with those of Piketty and Saez and Howell to the effect that public policies and private practices can exacerbate or mitigate the dis-equalizing impact of skill-biased technological change.

Barry Bluestone and Bennett Harrison also dispute the skill-biased technological change thesis. They argue that if it were correct, we would expect to find the most wage growth in science and technical fields. But this is not the case. Rather, they show that between 1979 and 1995, "the real winners in the earnings derby were not those on the forefront of the new computerized technologies, but medical doctors (up 43 percent), lawyers (24 percent) sales representatives and brokers (24 percent), and managers (15 percent)."<sup>22</sup> Bluestone and Harrison conclude that inequality must be seen as a combination of factors such as deindustrialization, deunionization, global trade, immigration, and the trade deficit.<sup>23</sup>

### ***A.II.2. The Shift From Manufacturing to Service Industries***

Another approach to explaining rising income inequality attributes the change to the shift in the United States from manufacturing to a service sector economy in the past twenty years. The argument is that manufacturing jobs are generally higher paid than service sector jobs, so that as the United States has undergone "de-industrialization," the incomes of those at the bottom have deteriorated. As Frank Levy and Richard Murnane write, former craftsmen and basic industry factory workers have "become 'hamburger flippers' in the service sector -- rather than engineers and market specialists."<sup>24</sup>

The reason why lower skilled service jobs have generally paid less than lower skilled manufacturing jobs is that service jobs, such as waitressing, lawn-cutting, or work in dry cleaning establishments, tend to be labor-intensive and thus subject to intense wage competition. Further, productivity grows slowly in service jobs because they are less likely to be automated. They are also less likely to be unionized. Thus the shift from manufacturing jobs to service jobs since the 1970s has led to more blue collar men and women in low-wage service jobs, and hence more

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Foundation, forthcoming); Bjorn Gustafsson and Mats Johansson, *In Search of Smoking Guns: What Makes Income Inequality Vary Over Time in Different Countries*, 64 *Am. Sociological Review* 585 (1999) (explaining different experience with inequality in Sweden, the United States and Finland in the 1980s on the basis of differences in trade union density).

<sup>22</sup> Barry Bluestone and Bennett Harrison, *GROWING PROSPERITY: THE BATTLE FOR GROWTH WITH EQUITY IN THE TWENTY-FIRST CENTURY* 193 (Houghton Mifflin, 2000).

<sup>23</sup> *Id.* at 196.

<sup>24</sup> Frank Levy and Richard J. Murnane, *U.S. Earnings Levels and Earnings Inequality: A Review of Recent Trends and Proposed Explanations*, 30 *J. of Econ. Lit* 1333, 1347 (1992).

inequality.<sup>25</sup>

While the shift away from manufacturing accounts for some of the increased inequality, it cannot tell the whole story. This is because there has been an increase in inequality within the service sector as well as within the manufacturing sector. Between 1979 and 1996, both the service and the goods producing sectors experienced the same pattern of widening disparities. As Frank Levy explains, "In economic terms, there was a surge in skill bias in both sectors that widened the earnings gap between men who had not gone beyond high school and men who had at least some college."<sup>26</sup> This leads back to the skill-biased technological change and the increasing returns to education factors discussed above. To the extent that these factors were also found to be incomplete, other factors must be explored.

### ***A.II.3. Income Dispersion Within Firms***

One aspect of the widening income distribution that is inconsistent with the increasing-returns-to-education hypothesis is that there has reportedly been an increase in earnings inequality within groups that are similar as to age, education, occupation, and other observable characteristics. Several economists have hypothesized that there has been a growth in wage dispersion within industries, and even within firms.<sup>27</sup>

A recent series of case studies financed by the Sloan Foundation test the skill-biased technological change thesis by exploring the impact of technological change on industry and firm-level income distribution. These researchers found that in industries that experienced technological change in the past twenty years, technological factors were not the sole, or even dominant, cause of either widening income disparities or lowering incomes at the bottom tiers. Rather, several found that changing work practices are a significant factor in explaining widening income disparities.<sup>28</sup>

Clair Brown and Ben Campbell, for example, found that amongst semiconductor fabrication plants, there has been considerable technological change that upgraded some skills and down-graded others. Brown and Campbell also found a shift to the use of higher-skilled workers, but they did not find that it was correlated with compensation

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<sup>25</sup> Frank Levy, *THE NEW DOLLARS AND DREAMS*, 60-62.

<sup>26</sup> *Id.* at 62.

<sup>27</sup> For a summary of some of these studies, see Levy and Murnane, *Earnings Levels and Earnings Inequality*, 30 *J. of Econ. Lit.* 1333, 1367 (1992).

<sup>28</sup> Harry C. Katz, *Industry Studies of Wage Inequality: Symposium Introduction*, 54 *Indus. & Labor Relations Rev.* 399 (2001).

levels or wage differentials. Rather, they found no systematic relationship between the implementation of new technologies, the returns to education, or wage inequality in the industry. Clair and Campbell conclude that the impact of new technology is filtered through a company's culture and overall employment system history.<sup>29</sup>

In a study of employment in the retail food industry, John Budd and Brian McCall similarly found that despite considerable technical change between 1984 and 1994, wage inequality did not increase. There the new technologies, such as the use of scanners at check-out counters, were not skill-biased upward, but rather lowered the skill requirements. As a result, Budd and McCall found that in grocery stores, deskilling technologies led to the lowering of wages throughout the distribution. They also found no increased returns to education in the grocery industry.<sup>30</sup> This study, like that of the semiconductor industry, demonstrate that not all technological change is skill-biased, and even when it is, it does not always lead to widening wage differentials

Thomas Bailey, Peter Berg and Carola Sandy studied the steel and apparel industries, where they found that workers in firms that used high performance work practices received higher pay. They defined high performance practices as participation on self-directed teams, assignment to high autonomy work tasks, and opportunities to communicate across departmental boundaries. Bailey, Berg, & Sandy found that those workers who were on self-directed teams or engaged in other high performance practices received not only higher pay, but also more variability in the pay. They posit that these results could be explained by the fact those workers in the high performance settings were given greater training and/or because employers used the incentives to elicit greater discretionary effort.<sup>31</sup>

Some of the researchers in the Sloan project found that skill-biased technological change can have an indirect effect on income inequality. Rosemary Batt, for example, found that for telecommunications services and sales workers, there has been significant wage dispersal since the break-up of the Bell system in 1983. In the same period, the introduction of new technologies have made many new marketing and service

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<sup>29</sup> Clair Brown and Ben Campbell, *Technological Change, Wages, and Employment in Semiconductor Manufacturing*, 54 *Indus. & Labor Relations Rev.* 450, 463 (2001).

<sup>30</sup> John W. Budd and Brian P. McCall, *The Grocery Store Wage Distribution: A Semi-Parametric Analysis of the Role of Retailing and Labor Market Institutions*, 54 *Indus. & Labor Relations Rev.* 484 (2001).

<sup>31</sup> Thomas Bailey, Peter Berg, and Carola Sandy, *The Effect of High-Performance Work Practices on Employee Earnings in the Steel, Apparel, and Medical Electronics and Imaging Industries*, 54 *Indus. & Labor Relations Rev.* 525 (2001).

offerings possible. Analyzing data from 354 service and sales centers, Batt concluded that business strategy and human resource policies were more significant than skill-biased technology per se in explaining patterns of wage inequality. For example, she found that firms engaged in what she terms “customer segmentation” – a practice separating residential and business consumers, and differentiating between high volume and low volume business consumers. The firms she studied hired workers with high school degrees to service residential consumers, but only hired college graduates to service large businesses. They did so because they believed that the latter customers required service personnel with greater skills in manipulating information systems and more adept at social interaction. These latter workers have higher human capital and provide higher value added, and accordingly showed significantly higher earnings. Batt concludes that the business strategy of customer segmentation might be an indirect mechanism through which skill-based technical change is translated into wage differentials.<sup>32</sup> Batt also found significant wage differentiation between call center establishments. Establishments that utilized variable pay and other high performance work practices had higher overall wage levels than those that did not.

The impact of changing work practices on intra-firm wage structures is illustrated most vividly in a case study by Larry Hunter, et. al. on human resource practices in the banking industry in the 1980s and 1990s. In that period, banks were adopting a host of new technologies, such as new hardware and software systems for handling accounts and ATMs for customer service. Also in that period, deregulation led to greater consolidation in the industry and intensified price competition among banks. With the repeal of the Glass-Steagall Act in 1997, banks and other financial institutions were able to diversify their services, so that banks began to compete with brokerage houses and mutual funds to sell investment products as well as checking accounts and loans<sup>33</sup>

Hunter and his co-authors report on the human resource restructuring undertaken by two banks in the face of this increased competition and technological change. In both banks, there was a growing gap in the functions and the earnings between the bank tellers and the “platform workers,” the people who open accounts or receive loan applications.

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<sup>32</sup> Rosemary Batt, *Explaining Wage Inequality in Telecommunications Services: Customer Segmentation, Human Resource Practices, and Union Decline*, 54 *Indus. & Labor Relations Review* 425 (2001).

<sup>33</sup> Larry W. Hunter, Annette Bernhardt, Katherine L. Hughs, and Eva Skuratowicz, *Its Not Just the ATMs: Technology, Firm Strategies, Jobs and Earnings in Retail Banking*, 54 *Indus. & Labor Relations Review* 402 (2001) (Special Issue on *Industry Studies of Wage Inequality*)

Tellers remained responsible for providing routine services such as check cashing, while the job of the platform worker was redefined. Those in the latter jobs, renamed "Personal Banker" or "Financial Specialist," became responsible for promoting sales of a variety of banking products and providing financial counseling to high-yield customers who required personalized services. To appeal to the high-end of the customer population, the banks required a college degree for the position. They selected polished workers with a professional demeanor for these new positions. These newly professionalized jobs paid considerably higher than the teller jobs. Thus like Batt's call center workers, the banks' impetus to hire college graduates was not skill-biased technological change but rather a desire to engage in strategic customer segmentation, by which the more profitable customers were routed to the more professional types of workers.<sup>34</sup>

In one respect, the trend of customer segmentation and the preference for college-educated workers to service profitable customers reported by both Hunter and Batt is a feedback loop in the widening income distribution story. As firms confront a more income-dispersed customer base, they adopt marketing practices that further disperses the income distribution.

These studies and others of their ilk suggest that the adoption of the high performance work practices of the boundaryless workplace operate independently of, but often in conjunction with, technological change to provide at least a partial explanation for the rising inequality of the past twenty years. When jobs are redesigned to provide greater flexibility, their skill requirements also increase. When this occurs, changes in firm-level income distribution that mirrors changing differential skill levels is a response not to changing technology but to new employment practices.<sup>35</sup>

#### ***A.II.4 The Impact of Digital-Era Employment Practices on Wage Inequality***

It stands to reason that a departure from internal labor markets leads to more dispersion in pay levels. In internal labor markets, wages were not set by the external labor market, but rather by institutional factors such as seniority and longevity. Internal labor markets, like labor unions, thus have been a force for wage compression as well as a cushion from external labor market forces. The dismantlement of internal labor markets together with the decline in unions removes pressure for wage

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<sup>34</sup> Id. at 419-21.

<sup>35</sup> Thomas Bailey, 1988. See also, Peter Capelli, *Are Skill Requirements Rising? Evidence from Production and Clerical Jobs*, \_\_\_ Indus. & Labor Relations Rev. 515 (1993).

compression. Instead, wages are increasingly pegged to other factors.

There are two respects in which the new workplace produces widening disparities in income, between and within categories of workers, and between as well as within firms.<sup>36</sup> First, new compensation practices such as incentive pay schemes, skill-based pay, and market based pay almost by definition generate wide pay differentials within firms. In jobs where performance is highly variable, the trend is to base wages on individual performance wherever possible. Thus in today's workplace it is not uncommon for workers doing identical tasks to have different pay.<sup>37</sup> In jobs where performance is routine and predictable, benchmarking can be used to set wages according to the going rate for the particular job, and thus break the lock-step wage patterns of internal labor market or union compensation schedules.

Benchmarking, which began as a technique for evaluating work design and enhancing technical efficiencies, has also become a mechanism by which compensation levels are reassessed and pegged to market rates. With benchmarking, an expert identifies discrete tasks or functions that are performed within a firm and compares them to the same functions in other firms. The comparison yields information about work design and also about costs. Thus, firms can compare their labor costs for a particular portion of their work processes. A firm can identify the "going rate" for a particular collection of tasks, and then apply that rate inside its own operations so as to set the rate for those jobs in accordance with the external market. Benchmarking thus removes the protective shield of internal wage-setting devices and makes workers within the firm vulnerable to competition from similarly tasked workers on the outside. In other words, benchmarking imports the wage dispersion of the external labor market into the wage structure of the firm.<sup>38</sup>

The second respect in which new employment practices generate intra-firm inequality is through the talent wars to obtain superstars. As Robert Frank and Philip Cook have documented, a large number of occupations have become "winner-take-all markets" in which the very best commands a price far beyond that of its nearest competitors.<sup>39</sup> The top firms want those top performers and are willing to pay a disproportionate price to get them. As part of the talent wars, firms use the carrot of off-the-scale

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<sup>36</sup> FRANK LEVY, *THE NEW DOLLARS AND DREAMS: AMERICAN INCOMES AND ECONOMIC CHANGE 2* (1998) (summarizing data on rising income inequality in the 1980s and 1990s); *see also* ROBERT FRANK & PHILIP J. COOK, *THE WINNER-TAKE-ALL-SOCIETY* 211–31 (1995) (discussing the increasing gap in income between the top and the bottom in the U.S. labor market).

<sup>37</sup> See Peter Capelli, *THE NEW DEAL AT WORK*, at \_\_\_\_.

<sup>38</sup> Capelli, in ??

<sup>39</sup> ROBERT FRANK & PHILIP J. COOK, *THE WINNER-TAKE-ALL SOCIETY*, *supra*.

salaries and generous compensation packages to lure and retain those it sees as top performers, regardless of the impact such big disparities could have on others. Over time, such practices lead to vast disparities between employees at the same level as similarly situated employees are differentially rewarded.<sup>40</sup> The talent wars also foster gaping earnings disparities between individuals in different levels, because the more highly skilled occupations are those in which competition for talent are most aggressive.

Thus current digital era human resource practices are contributing to income inequality. Both the tendencies toward wage dispersion within firms and toward income tournaments at the top are features of the new workplace that accelerate the other processes generating income inequality.

#### ***A.II.5. The Impact of Globalized Production on Income Inequality***

While changing human resource practices and skill-biased technological change are factors in the widening income distribution, so too is the increase in global production and the policies of trade liberalization. With increased global trade and the relaxation of import barriers, goods produced with low-cost labor are able to out-compete domestically-manufactured items. As a result, domestic low wage workers are forced to compete with low wage workers in developing countries for jobs. The same results flow from direct foreign investment and the use of foreign subcontractors, in which domestic manufacturers shift production to low-wage countries for those part of their operations that can utilize foreign, low-wage labor. Workers for any company whose goods are traded in the global market, or whose company makes goods that compete with goods traded in the global market, is vulnerable to downward pressure on wages.<sup>41</sup> According to Bluestone and Harrison, "To the extent that companies move their facilities to take advantage of cheaper unskilled labor or outsource domestic production to cheaper offshore sites, transnational investment adds to the effective supply of low-skilled labor available to American firms, accelerating the entire dis-equalizing process."<sup>42</sup> M.I.T. economist Frank Levy claims that increased global trade has two effects on wages. It both decreases the demand for blue collar workers domestically, and it makes the demand for all types of

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<sup>40</sup> See, e.g., DAVID LEBOW ET AL., RECENT TRENDS IN COMPENSATION PRACTICES 8 (1999) (reporting on a Federal Reserve study that found firms are increasingly using compensation systems that permit greater differentiation among employees).

<sup>41</sup> Adrian Wood, NORTH-SOUTH TRADE, EMPLOYMENT AND INEQUALITY: CHANGING FORTUNES IN A SKILL-DRIVEN WORLD (Oxford Univ. Press, 1994).

<sup>42</sup> Bluestone and Harrison, GROWING PROSPERITY, supra. at 195.

employment –white and blue collar alike – more elastic because firms have greater freedom to substitute overseas production for domestic production. In both respects, global trade increases job insecurity and strengthens management's bargaining power vis-a-vis all but the most highly skilled employees.<sup>43</sup>

David Howell also argues that trade liberalization enhances inequality because it leads to more global wage competition for low-skilled labor. He contends that the more certain types of labor can be outsourced or are otherwise exposed to low-wage, foreign competition, the more firms will be tempted and able to reduce the wage for that type of labor. This can explain the observed increases in intra-firm wage as well as overall wage differentials. According to Howell, "Jobs least sheltered from downward pressures (those least difficult to outsource, that require no idiosyncratic skills, etc.) experience declining relative (and real) earnings."<sup>44</sup>

The factors of technological change, new employment practices and global production are often inter-related. Several economists have found that flexible wage practices are most frequently adopted by firms that are most exposed to foreign trade.<sup>45</sup> For example, Princeton economist Marianne Bertrand finds that companies that face competitive pressures from the global marketplace have adopted flexible wage policies.<sup>46</sup> A study of British confectionary companies also found that those firms whose products competed in a global market were more likely to adopt the boundaryless job structures.<sup>47</sup> That is, increasing global competition subjects many firms to increased market pressure, that in turn induces them to adopt the kinds of boundaryless work practices that involve a dispersal of firm-level incomes. And as firms dismantle internal labor markets and rely on an external labor market for their hiring needs, they have less incentive to protect their workers from the dynamic of decline.

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<sup>43</sup> Frank Levy, *supra*, at 91-92. Gary Burtless, Robert Lawrence, Robert Litan and Robert Shapiro dispute the claim that increased trade generates increased income inequality. They argue that earnings inequality is growing in industries that are not affected by trade to the same degree as it is in industries that are affected by trade. Thus they conclude that the impact of skill-biased technological change dwarfs any adverse impact that trade might have on income inequality. However, Burtless and his co-authors do not explain how they are determining which industries they define as trade sensitive, thus making it difficult to evaluate their claim. Burtless, et. al., *GLOBALAPHOBIA*, at 79-84.

<sup>44</sup> Howell, *supra*, n. \_\_\_\_ at 77- 79, n. 10.

<sup>45</sup> See Mason, *supra* note 182, at 211-12.

<sup>46</sup> See Marianne Bertrand, *Changes in the American Workplace*, in *PROC.*, 52D ANN. N.Y.U. CONF. ON LABOR & EMP. L. (1999).

<sup>47</sup> add cite.

### ***A.III Rising Income Inequality: Why Explanations Matter***

A multi-factored understanding of rising inequality means that no one public policy can reverse the dynamic. If skill-biased technological change were the whole story, then we might understand the present level of income inequality as a transitory phenomenon -- the result of a time lag. With the dizzying pace of technical change, the theory suggests, some people failed to get skills, or the right skills, to succeed. Whether due to individual ineptitude or institutional failure, their poverty is the result of inadequate education, training, or talent. The solution, in this view, is to improve training and education for the ill-equipped and hope that their those coming after them obtain better, or at least more current and flexible, skills.

Once we move beyond the skill-biased explanation to a multi-factored one, we are forced to abandon a singular emphasis on training policy and instead entertain a wide range of policy proposals at the macro-economic and political level. A number of proposals of this sort are presented and evaluated in the next section. Before turning to the policy proposals, it is necessary to address the argument, frequently asserted, that the trend toward more inequality cannot be reversed at all without compromising economic growth.

Many economists argue that unequal income distribution is a necessary but regrettable dimension of economic policies that enhance growth. In this view, the rise of digital technology, the growth of the service sector, trade liberalization, deregulation of domestic economic life, new workplace practices and the weakening of labor unions all enhance growth and overall welfare, but have a negative impact on equality. If so, then it is at least arguable that we must choose between overall growth and equality. Or, if we choose growth, at the very least, we must identify tools that can compensate for the resulting inequities without derailing or diminishing growth.

Some economists have challenged the growth-inequality syllogism on the grounds that in some circumstances, inequality can serve as an impediment to growth.<sup>48</sup> Bluestone and Harrison go further, and argue that best antidote for rising inequality is to generate more growth. They claim that if the government pursued macro-economic policies that encouraged economic growth, then eventually much of the present income inequality would disappear. They present evidence to show that in periods of high growth, the bottom groups in the income distribution fare relatively well. However, they also opine that current policy-makers are

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<sup>48</sup> Kanbur, Thornbeck, Blau & Kahn

too obsessed with controlling inflation and supporting moderate growth, rather than generating the red-hot growth that would be necessary to reverse the dis-equalizing effects of technological change, trade liberalization, deunionization, and deindustrialization.<sup>49</sup>

While growth might well be the solution to rising inequality, it is necessary to consider other ameliorative policies. As history demonstrates, economic growth can be an elusive aspiration, less a beacon for policy-makers than a frustrating mirage. Too many other factors intervene. Wars, droughts, attacks on the World Trade Center, foreign currency crises, and shifting political winds all affect economic growth. There is no simple formula for success. So while growth, or rather equitable growth, can be a powerful antidote to rising income inequality, other policies must also be considered. To those we now turn.

### **B. Promoting Equality, Opportunity, and Stability in the Digital Workplace**

Growing inequality threatens the integrity and moral authority of the social order. Those locked out of the world of economic opportunity are locked into a perpetual underclass, often exhibiting anti-social behaviors such as drug use, alcoholism, and crime. The social problems that result from the widening chasm between social strata can undermine the legitimacy of our governmental institutions. If, as I argued above, the emerging digital era job structures play a role in generating income inequality, then we must confront a choice. We can redress inequality by seeking to arrest the spread of new workplace practices or we can develop a plausible macro-economic and political program for redistribution. The former approach would probably be futile as well as detrimental to overall growth – a sort of Twentieth-First Century Ludditism. Instead, it is more feasible to devise policies to redress the rising inequality and vulnerability that are created by the new work practices. To preserve an acceptable level of equality and cohesion in society, redistribution need to be placed prominently on the national political agenda.

There are a myriad of proposals currently circulating to address the widening income distribution, many of which have been tried in some form or other in recent years. The most frequently discussed reform proposals are: increasing the minimum wage, expanding the earned income tax credit, providing wage subsidies, providing cash grants to the poor, and establishing a system of universal citizen stakeholding. The first three are redistributive measures that are employment-centered and

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<sup>49</sup> Bluestone and Harrison, *Growing Prosperity*, supra. at 202-204.

require participation in the labor market by beneficiaries, while the latter two are redistributive measures that operate independently of labor market participation. In this chapter, I describe and evaluate each of these. I then discuss proposals that, while not explicitly redistributive, are designed to give individuals the flexibility they need to participate in today's labor market. These include proposals for training, child care, and insurance portability. I also present a European proposal that employees be able to accumulate "social drawing rights" that they can use to ease career transitions. This proposal is designed to help individuals cope with the insecurity that results from the flexibilization of work. While these latter proposals do not directly address issues of income distribution, they would help individuals navigate and prosper in the new labor market. I conclude that these types of proposals, combined with some of the more explicitly redistributive ones, are necessary to address the twin problems of worker vulnerability and deteriorating income distribution in the digital era.

## **B.I Redistribution Through the Labor Market**

### ***B.I.1 The Minimum Wage***

One of the best known social programs for redistributing income is the minimum wage. Enacted in 1935 as part of the Fair Labor Standards Act, the federal minimum wage sets a floor for wage rates for all employees whose job is involved in interstate commerce.<sup>50</sup> While the minimum wage level has been raised from time to time, it is not indexed for inflation. The level of the minimum wage level peaked in 1969 at over \$7.50 per hour in 1999 dollars, but has never come close to that level since. The minimum wage declined sharply in the 1980s because Congress failed to adjust it for nine years, reaching a low in 1989. There were several increases in the minimum wage in the 1990s that somewhat reversed the trend. However, even with the increases of the 1990s, inflation has so eroded the minimum wage that today it is 21 per cent lower than it was in 1979.<sup>51</sup>

The federal minimum wage has long been popular with the public but anathema to economists. Mainstream economists contend that the minimum wage raises wages above the competitive level, thereby causing employers to reduce employment. This results in a loss in employment opportunities for workers whose value to employers is less than the legislatively set minimum, and it also results in a sub-optimal level of output. Thus the criticisms of the minimum wage are primarily

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<sup>50</sup> 29 U.S.C. §§ 201-219.

<sup>51</sup> See *The Minimum Wage: Increasing the Reward for Work, A Report by the National Economic Council*, Chart 2 (March, 2000).

directed at its efficiency-defeating impact.

Economists David Card and Alan Krueger conducted an empirical study of fast food industry workers that challenged the claim that increases in the minimum wage will lead to declines in employment opportunities. Prior to 1992, New Jersey and Pennsylvania had the same minimum wage. But when the minimum was raised in New Jersey in 1992 without a raise in Pennsylvania, Card and Krueger found that the predicted drop in employment in the New Jersey fast food restaurants did not materialize. Rather, employment in the New Jersey establishments increased relative to those in Pennsylvania. This led them to hypothesize that sometimes small increases in the minimum wage could lead to expanded employment opportunities and thus to increased efficiency.<sup>52</sup>

The Card and Krueger finding initially generated considerable controversy within the economics profession because it appeared to challenge one of the basic tenets of the neoclassical model. However, many economists have come to concede that modest increases in the minimum wage appear might not be detrimental to employment. This may be particularly true in an period in which the minimum wage has failed to rise with inflation. If the minimum wage is set at a level below the competitive wage rate, then arguably increases would not lead to employment losses.<sup>53</sup>

For present purposes, the efficiency effects of the minimum wage are not as important as its distributional effects. The widespread popularity amongst the public of the minimum wage stems not from its impact on overall production but from its impact on wages. It is widely believed that the minimum wage causes wages to rise above the level they would otherwise be, and that a raise in the minimum wage would raise wages even higher. Card and Krueger tested this hypothesis by looking at the distributional impact of the increase in the federal minimum wage in 1990 and 1991. They found that the raise in the minimum wage, while small, provided a significant boost to the economic well-being of many low-income earners.<sup>54</sup> They also found that the 1990 and 1991 increases in the minimum wage affected overall income distribution. They report that the increases "rolled back a significant fraction of the cumulative rise in wage dispersion from 1979 to 1989 . . . [and] led to significant increases in the 10<sup>th</sup> percentile of family earnings, and to a narrowing of the gap

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<sup>52</sup> David Card and Alan B. Krueger, *MYTH AND MEASUREMENT: THE NEW ECONOMICS OF THE MINIMUM WAGE 20-69* (Princeton Univ. Press, 1995).

<sup>53</sup> cite AEA panel with Paul Samuelson, et. al.; Francine D. Blau and Larence M. Kahn, *Institutions and Laws in the Labor Market*, in O. Ashenfelter and D. Card, *HANDBOOK OF LABOR ECONOMICS*, Vol. 3 1400, 1442 (1999).

<sup>54</sup> Id. at 276-277.

between the 90<sup>th</sup> and 10<sup>th</sup> percentiles of family earnings.”<sup>55</sup> Rebecca Blank similarly found that the increases in the federal minimum wage in 1996 and 1997 also helped low income families.<sup>56</sup>

These findings support the popular belief that the minimum wage is an effective mechanism for redistributing income toward the lower end of the income distribution. None of these studies demonstrate that increases in the minimum wage help eliminate poverty. Because less than half of the poor work, and because those that do work often work part-time or intermittently, increases in the minimum wage do not translate into significantly higher incomes for the poor. Rather, the minimum wage is best understood as a means of protecting the wages and labor standards of the working poor, who otherwise could face a downward spiral as employers bid down the price of labor of those working at or near the bottom of the income distribution.<sup>57</sup>

### ***B.I.2 The Earned Income Tax Credit***

The largest federal redistribution program presently is the earned income tax credit (EITC). The EITC benefits primarily the working poor – the fastest growing portion of the labor force. It is a refundable tax credit for low income working families with children. Eligible individuals who earn less than the specified target amount get a tax credit for each dollar earned up to a set maximum benefit. The credit can be either a reduction in tax liability, or if liability is less than the credit, a check from the IRS for the difference. At present, a family with two or more children with parents working at the minimum wage would receive a rebate through the EITC that would be the equivalent of a \$2 per hour increase in pay. Between 1975 when the EITC began until 1999, the size of the program grew from \$3.9 billion to \$31.9 billion. It is currently the largest federal welfare program in the United States, dwarfing other federal programs for the poor, such as food stamps that came to \$19 billion in 1999, and Temporary Assistance for Needy Families (TANF) that came to \$16.7 billion in 1999. Unlike these other welfare programs, the EITC enjoys considerable popular and political support. It is widely regarded as a successful anti-poverty program that includes work incentives. In 1998, the EITC raised an estimated 4.4 million Americans above the poverty

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<sup>55</sup> Id. at 279.

<sup>56</sup> Rebecca M. Blank, *Fighting Poverty: Lessons from Recent U.S. History*, 14 J. of Econ. Perspectives 3, 14 (2000).

<sup>57</sup> See Timothy J. Bartik, *JOBS FOR THE POOR: CAN LABOR DEMAND POLICIES HELP?* 278-284 (Russell Sage, 2001)

line.<sup>58</sup>

The original EITC, proposed by Senator Long in 1975, gave taxpayers with children a ten percent supplement for wages up to \$4000, and phased out the supplement for incomes between \$4000 and \$8000. The EITC remained essentially unchanged until the Tax Reform Act of 1986, when the amount of the supplement was increased to equal its real value in 1975, with indexing for future inflation. The EITC was expanded again in 1990, as part of the overall tax bill that raised rates and limited deductions for high income taxpayers. Congress further expanded the EITC on several occasions in the 1990s, with the goal of using the credit to raise every full-time wage workers' pay to the poverty level. In 1998, it was modified to provide a modest amount of benefit for taxpayers without children. At present, a wage-earner with two children earning \$8500 a year can receive approximately \$3370, bringing them above the poverty line.<sup>59</sup>

The EITC is widely viewed as a valuable policy tool for redressing inequality. Rebecca Blank says the expansion of the EITC in the 1990s "may be the most important anti-poverty policy implemented during this decade."<sup>60</sup> Timothy Bartik says there is "little doubt that the EITC's effect is to truly raise net wages after taxes for many of the working poor."<sup>61</sup> Barry Bluestone and Teresa Ghilarducci state that the EITC not only raises wages, but also provides "wage insurance for the temporary poor in an era of job instability and earnings insecurity." They contend that EITC benefits not only the entrenched underclass of long-term unemployed, but also those whose wages are falling or who are at risk of temporary unemployment due to corporate restructuring.

Some economists have expressed concern that the EITC could lower wages by inducing employers to hire the same workforce for less and simply letting the government pay the difference. In that event, the EITC would prove to be a subsidy for low-wage employers. However, to counter that potential negative consequence, Bluestone and Ghilarducci argue that the EITC should be combined with raising the minimum wage and indexing it for inflation.<sup>62</sup> Rebecca Blank also advocates that the EITC

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<sup>58</sup> Council of Economic Advisors, 1998. See also, Bartik, *supra.* at 77-80; Katherine S. Newman, *NO SHAME IN MY GAME: THE WORKING POOR IN THE INNER CITY* 271 (Random House, 1999).; Council of Economic Advisors, 2000..

<sup>59</sup> V. Joseph Hotz & John Karl Scholz, *The Earned Income Tax Credit*, NBER Working Paper No. 8078, at 1-8 (January, 2001); Joel F. Handler, *Low Wage Work "As We Know It,"* in Joel F. Handler & Lucie White, *HARD LABOR*, 3, 13-14 (1999)

<sup>60</sup> Rebecca M. Blank, *IT TAKES A NATION: A NEW AGENDA FOR FIGHTING POVERTY*, 113 (1997).

<sup>61</sup> Bartik, *JOBS FOR THE POOR*, *supra.* at 80.

<sup>62</sup> Barry Bluestone and Teresa Ghilarducci, *Making Work Pay: Wage Insurance for the Working Poor*, 28/ 1996 Public Policy Brief (1996).

should be expanded and combined with an increased minimum wage. She warns that increases in the minimum wage alone could lead to increased unemployment. However, if raising the wage floor were combined with an expansion of the EITC, Blank contends that the latter policy would induce more nonworkers to join the labor force, and thus the combination could combat the negative employment effects of the former. She advocates such a combination because it "makes full-time, full-year work much more attractive."<sup>63</sup>

Francine Blau and Lawrence Kahn also argue that the EITC is a valuable approach to ameliorating income inequality, but they see it as an alternative rather than as a complement to the minimum wage. Blau and Kahn analyze the minimum wage, as do most economists, as a policy that distorts the labor market and reduces employment opportunities at the bottom. They prefer the EITC because it raises after-tax wages of low income workers without interfering in the labor market. It enables employers to hire more workers without increasing their employers' labor costs, and thus unlike the minimum wage, it would not induce employers to reduce employment levels.<sup>64</sup>

Whether or not it is combined with a minimum wage hike, the earned income tax credit has the potential to redistribute income to the lower end of the income distribution. If it were expanded, it could have significant redistributive impact. Further, because its benefits are based on annual income, it assists individuals who move in and out of the labor market during the course of the year, making it a redistribution program that addresses the precarious employment experience of the digital era.

The EITC is not beyond criticism, however. It is expensive, and if it were expanded it would cost even more. And because benefits are only paid once a year as an income tax refund, the credit does not provide cash for emergencies. Its lump sum pay-out can also dampen the program's ability to encourage recipients to seek full-time work. Also, the program has lower than expected participation rates, presumably because there are many who would be eligible who do not file income tax returns. In addition, it has a high error rate, again possibly attributable to the complex IRS forms that need to be completed to obtain benefits. Many of these short-comings could be cured with better information and more user-friendly filing requirements.

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<sup>63</sup> Blank, *IT TAKES A NATION*, *supra*. at 114-116.

<sup>64</sup> Francine D. Blau and Lawrence M. Kahn, *US LABOR MARKET PERFORMANCE IN INTERNATIONAL PERSPECTIVE: THE ROLE OF LABOR MARKET INSTITUTIONS* (New York, Russell Sage Foundation, forthcoming).

### B.I.3 Wage Subsidies

#### *a. Targeted Subsidies*

Rather than give subsidies to employees to bring their earnings above the poverty level as the EITC does, some analysts have proposed a government subsidy paid to employers to raise the wages of low-income workers. In the past, wage subsidies have been used to assist certain targeted groups for a limited period of time. In 1979, Congress enacted the Target Jobs Tax Credit, and in 1996 it enacted the Work Opportunity Tax Credit, both of which gave private-sector employers a subsidy to employ certain targeted groups, such as welfare recipients, disadvantaged youths, and ex-criminals. The results of these programs were mixed. Several researchers found that they had a negative effect on the employment of the targeted workers. They surmised that the subsidy stigmatized the targeted job-seekers and thus made employers reluctant to hire them despite the financial inducement to do so. According to economist and former Clinton appointee, Lawrence Katz, sending in a welfare recipient to a job interview with a wage subsidy voucher is like saying, "Hi. I'm a lemon -- give me a job!" Others, however, claim that the stigma factor was exaggerated, and some have found that the programs yielded positive effects on the job opportunities of some categories of disadvantaged workers.<sup>65</sup>

#### *b. The Phelps Proposal*

One of the most ambitious wage subsidy proposals has been put forward by Edmund Phelps in his 1997 book, *REWARDING WORK*. Phelps' proposal is aimed to assist all who lie at the bottom of the income distribution. Rather than a time-limited and target wage subsidy, Phelps proposes a universal, unlimited one. It is an ambitious and expensive program, costing taxpayers an estimated \$125 billion in 1997 -- up to \$132 in 1998. This enormous sum, he claims would be offset by increased taxes and by the savings from reduced crime, unemployment benefits, Medicaid, welfare payments, and the elimination of the EITC.<sup>66</sup>

Phelps' proposal grows out of his analysis of income inequality. He

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<sup>65</sup> On the negative consequences of targeted wage subsidies, see Lawrence F. Katz, *Wage Subsidies for the Disadvantaged*, NBER Working Paper 5679 (1996); Gary Burtless, *Are Targeted Wage Subsidies Harmful?* 39 *Industrial and Labor Relations Review* 105 (1985). On the positive effects of targeted wage subsidies amongst certain discrete populations, see Katherine Newman, *NO SHAME IN MY GAME, THE WORKING POOR IN THE INNER CITY* 270-71 (1999); John H. Bishop and Mark Montgomery, *Does the Targeted Jobs Tax Credit Create Jobs at Subsidied Firms*, 32 *Indus. Relations* 289 (1993). See also, David Whitman, *Take This Job and Love It*, U.S. News & World Report, October 14, 1996.

<sup>66</sup> EDMUND S. PHELPS, *REWARDING WORK* (1997).

points out that in 1990, those in the bottom tenth of the income distribution -- some 12 million in all -- earned less than \$4 an hour and, due to part-time work and/or spells of unemployment, had annual earnings of \$1,200 on average. The next portion of the income distribution did not do much better. Phelps calculates that those in the bottom third of the income distribution suffer from serious economic disadvantage.<sup>67</sup> In addition to the concern about absolute deprivation, Phelps maintains that it is important to redress the relative deprivation of low-paid workers. As he says, "The pay of America's lowest lifetime earners has become so remote from the pay of the median earner as to make them a class apart, with radically diminished possibilities next to those in the mainstream."<sup>68</sup>

Phelps attributes the problem of low wages of the working poor to their low productivity.<sup>69</sup> In addition, he contends, the advent of information-intensive production increases the low-wage workers' disadvantage. The less well-educated are not likely to be selected for jobs that involve handling and/or processing information, so that "the flow of new technical information widens the gap between low-wage and median-wage workers." Similarly, employers are unwilling to invest in training for low-educated workers, so their relative disadvantage in the labor market increases. For these reasons, Phelps argues, neither traditional welfare programs nor employment-based social insurance can reverse the low-wage cycle of low-educated workers.<sup>70</sup>

Instead of programs that ameliorate the problems of the nonworking poor, Phelps proposes a solution for the working poor: that the federal government pay employers to raise the wages of their low-income employees. For example, an employer whose employees cost \$4 an hour in wages, benefits, and payroll taxes would receive a subsidy from the state to bring up that workers wages to some set minimum amount, posited at \$7. To avoid perverse incentives, he proposes that the subsidy be structured to decline as hourly wages increase. As Phelps explains, "The subsidy is thus like a matching grant rewarding the firm for as many workers as it employs, particularly workers whose private productivity is low (as evidenced by the low hourly labor cost that firms are willing to incur for their services)."<sup>71</sup>

Unlike the targeted wage subsidy programs attempted in the past, Phelps' proposal would give subsidies to employers of all types of low-

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<sup>67</sup> PHELPS, *Id.* at 23-26.

<sup>68</sup> *Id.* at 103.

<sup>69</sup> *Id.* at 65.

<sup>70</sup> *Id.* at 68.

<sup>71</sup> *Id.* at 106.

wage workers. He claims that the subsidy would not only pull up wage rates, but also reduce unemployment by giving employers an incentive to hire some whom they would not have employed otherwise. He justifies the subsidies on the ground that existing wages reflect only a worker's private productivity to an individual employer. The subsidy, on the other hand, would bring up the wage to his "social productivity" – the contribution of the employee to society.<sup>72</sup> Phelps explains that the employment has third party effects that go beyond the private benefit conferred on the worker and the employer. The social benefit of employment is the benefit workers confer on the rest of society "from their position as participants in the business life of their community and the country, earning their own keep and supporting their children and setting an example for others growing up in their neighborhood."<sup>73</sup> Ideally, he says, the size of the income subsidy should make the wage equal to the worker's external productivity– the private benefit and the social benefit that the worker provides. In this way, he argues, wage subsidies would have benefits for the taxpayers who would be called upon to pay for the proposal.

Phelps' proposal conditions the subsidy on having a job. He justifies this approach by arguing that a redistributive program should encourage labor market participation because employment is more than a means of self-support -- it is a form of personal development and community building. Phelps is critical of proposals for redistribution that give people an incentive not to join the labor force, and thus "do nothing to restore jobholding as the means of self-support and the vehicle for personal growth and the sense of belonging and being needed."<sup>74</sup>

### *c. Critiques of Wage Subsidies*

A number of analysts have voiced criticisms of wage subsidies. Some have criticized the Phelps' wage subsidy proposal for its extremely high cost. While it is predicted to produce large increases in both employment and wages, the price tag of over \$132 billion makes it an expensive gamble should such positive results not be forthcoming.<sup>75</sup>

Yale Law School Professor, Anne Alstott, has attacked wages subsidies of all types.<sup>76</sup> She argues that targeted subsidies have multiple failures,

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<sup>72</sup> Id at 106–09.

<sup>73</sup> Id. at 124.

<sup>74</sup> Id. at 112.

<sup>75</sup> Bartik, *JOBS FOR THE POOR*, supra. at 242-244.

<sup>76</sup> Anne L. Alstott, *Work vs. Freedom: A Liberal Challenge to Employment Subsidies*, 108 *YALE L.J.* 967, 1056–58 (1999).

including encouraging displacement of nontargeted workers, stigmatizing the targeted workers, creating perverse incentives for employers to engage in workforce churning, and incurring high administrative costs. Unlike these, she says, the Phelps' proposal is elegantly simple, ambitious, and bold.<sup>77</sup> By giving coverage to all low wage workers throughout the workers' entire career, the Phelps' plan solves many of the administrative problems and creates fewer perverse incentives than more limited and targeted wage incentive programs.

Despite such praise, Alstott is sharply critical of Phelps' proposal. She contends that by requiring work, the program could discourage individuals from obtaining additional education and training and hence could impede their labor market opportunities in the future. In addition, she argues that the program is not well targeted. Because it gives subsidies to all low-wage earners, it assists middle-class teens and secondary earners as well as the poor. Third, she claims the program has serious administrative costs because employers will have an incentive to fraudulently understate wages and overstate hours. Fourth, she claims that employers will have an incentive to displace higher paid workers with lower paid ones. Fifth, the program gives workers a disincentive to move to higher wage positions because, while they will earn more, the marginal gain will be small. And finally, because the program assists employers who can utilize low-wage workers, she claims it will aid employees in the suburbs more than those in the cities.

While Alstott characterizes these problems as "damaging facts,"<sup>78</sup> it would be equally plausible to see them as challenges to be faced in program design. None seem as damaging to society as the existing maldistribution of income. Indeed, some of her objections seem exaggerated. For example, any disincentive that a wage subsidy raised to participation in training programs could be more than offset by the enhancement to an individual's labor market opportunities that follows from actual labor force participation.

As to claim that the proposal causes geographic distortion, it is not necessarily bad economics for firms that have lower labor costs to locate on the periphery of cities. Regional economists have found that in information-intensive economies, cities have agglomeration economies in producer service sectors, not in manufacturing.<sup>79</sup> Further, there are many low wage jobs in cities -- such as low-skilled jobs in hotel, restaurants, and hospitals -- that would be candidates for Phelps' wage subsidies.

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<sup>77</sup> Id. at 1042- 43.

<sup>78</sup> Id. at 1045.

<sup>79</sup> Saskia Sassen, *GLOBAL CITIES*; Matthew Drennan . . .

Alstott's concern about fraud is serious but not unique to the wage subsidy proposal. Potential for fraud has plagued tax programs and social welfare programs for years, and the antidote is for Congress to design and fund meaningful compliance systems. Although Alstott quite rightly states that the Phelps proposal would require accurate information on employers' wage rates and hours worked, it seems like a reporting system for that purpose could be designed. While one can take issue with Alstott over whether the wage subsidy glass is half full or half empty, she has a more fundamental critique of the wage subsidy program. Her main argument is that assistance that is conditioned on employment interferes with an individual's freedom to determine one's own trade-off between remunerative and nonremunerative activities. According to Alcott, there is no reason to privilege labor market participation – some individuals may want or need to spend their time taking care of children or pursuing other objectives. To enable individuals to make a choice about how to spend their time, Alstott advocates a program of cash allowances, or a negative income tax for the poor, as preferable forms of redistribution. I address Alstott's liberty-based argument later in this chapter, in the context of a discussion of cash grants to the poor.

#### **B.I.4 Comparing the EITC with the Wage Subsidy Proposal**

Assuming that both the EITC and the Phelps' wage subsidy proposal are viable mechanisms for redistributing income, the question remains, which is preferable. As Lawrence Katz notes, "In a simple Coasian world without transaction costs or imperfect information, it should not matter whether wage subsidies are provided to employers or equivalent earnings supplements provided to workers." But Katz goes on to say, "There are many reasons why the side of the market in which the subsidy is provided could matter in practice."<sup>80</sup>

One way that the side of the market matters is that targeted wage subsidies paid to employers identify who is being subsidized and implicitly suggests they are bad workers. The EITC, by ensuring payments to the employees directly, avoids any stigmatizing effects of targeted wage subsidies. But, Phelps' proposal for a universal low-wage subsidy avoids the problem as well.

The two programs potentially differ in terms of the economic incentives and effects they create. Where there is in effect a minimum wage acts that is a constraint on the downward movement of wages, employee-side subsidies such as the EITC can raise earnings effectively

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<sup>80</sup> Lawrence F. Katz, *Wage Subsidies for the Disadvantaged*, NBER Working Paper 5679, at 6 (July, 1996).

because employers cannot simply reduce wages to offset the amount of the subsidy. Yet without the ability to reduce wages, employers may not have an incentive to increase employment. Conversely, in the presence of a constraining minimum wage, employer-side wage subsidies can permit employers to lower wages when they could not have done so previously without violating the minimum wage. In that event, the subsidy could have the effect of lowering wages but increasing employment. Thus the choice between the programs might turn on which is the dominant objective.

It has also been argued that the two types of subsidies differ in terms of their ability to target benefits to the intended beneficiaries. Wage subsidies paid to employers of low-wage workers could have the unintended effect of assisting many who are not truly needy. Low wage workers include teenagers and secondary earners in middle class households. In this light, the EITC is preferable because it operates through the income tax, which is a more reliable mechanism for identifying the needy.<sup>81</sup> By operating through the income tax system, the EITC might also be preferable to employer-paid subsidies in terms of ease of administration and discouragement of cheating, although the case is by no means clear.<sup>82</sup>

There is a danger that any form of wage subsidy will induce employers to lower wages and then hire subsidized workers to replace unsubsidized ones, thereby giving the employer a windfall rather than raising the low-wage worker's earnings. This danger is more serious with the Phelps plan than the EITC. With the Phelps plan, the employer knows which workers are eligible for the subsidy, and can downwardly adjust their wages to offset the subsidy while keeping the unsubsidized workers pay at a level sufficient to keep them employed. With the EITC, the employer does not know which workers are subsidized, because the employer does not know the workers' total family income. In that case, if the employer lowers wages, it risks losing its unsubsidized workers who will refuse to work at the lower pay rate. The fact that employers cannot know which worker is eligible for the subsidy under the EITC is therefore an advantage in the ability of the subsidy to actually raise wages of the program's

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<sup>81</sup> Stacy Dickert-Conlin and Douglas Holtz-Eakin, *Employee-Based Versus Employer-Based Subsidies to Low-Wage Workers: A Public Finance Perspective*, in David Card and Rebecca M. Blank, eds. *FINDING JOBS: WORK AND WELFARE REFORM* 262, 269 & 291 (Russell Sage Foundation, 2000).

<sup>82</sup> Anne Alstott argues that the it is a close question which of the two programs -- employee-paid or employer-paid subsidies -- is superior in terms of ease of administration and prevention of fraud. Alstott, *Work and Freedom*, at 1052-54.

beneficiaries.<sup>83</sup>

There is one additional factor that argues in favor of the EITC over wage subsidies. As Alstott points out, the Phelps proposal would only assist full-time workers, and thus would impose a full-time work requirement on its beneficiaries. The EITC, on the other hand, assists those whose work is part-time. Thus the EITC permits workers to retain the benefit while adjusting their work schedules to their own life exigencies. For these reasons, Alstott claims, the EITC at least partially realizes her goal of preserving each individual's freedom to spend their time as they choose. In addition, as Bluestone and Ghilarducci point out, the EITC benefit is triggered by low income rather than low pay, so that it assists workers who suffer temporary layoffs or other employment transitions. Thus it is responsive not only to the low pay, but also to the other vicissitudes and vulnerabilities of the boundaryless workplace.

## **B.II Non-Workplace Centered Redistributive Measures**

Some policy analysts propose that the problem of growing inequality be addressed through measures that provide cash grants to those outside the labor market or on the lowest rungs without conditioning benefits on labor market participation. Some advocate a return to the federal welfare program, AFDC, that Congress abolished in 1996, a system that focused assistance on the nonworking poor with dependent children. Yet others propose a negative income tax -- using the tax system to provide cash grants to the working and nonworking poor, with a phase-out of the benefit as income rises. Yet others have proposed a stakeholder program that would give a cash grant to every young adult in the country upon the attainment of majority, financed by the federal income tax. Unlike the proposals discussed in the previous section, these proposals do not condition public assistance on participation in the labor market.<sup>84</sup>

### **B.II.1 Cash Grants**

The policy of giving public assistance to the disadvantaged goes back many centuries and has taken many forms. In the United States, since the 1930s there has been a federal welfare program that provides cash grants to the disadvantaged. The Social Security Act of 1935 contained a program called Aid to Dependent Children, later renamed Aid to Families with Dependent Children (AFDC), that provided cash grants to poor women to enable them to stay out of the labor market to raise children. The program was expanded considerably during the Great Society's war

<sup>83</sup> See Rebecca Blank, *Enhancing the Opportunities, Skills, and Security of American Workers*, in DAVID T. ELLWOOD, ET. AL., EDS. *A WORKING NATION: WORKERS, WORK AND GOVERNMENT IN THE NEW ECONOMY* 105, 117-118 (Russell Sage Foundation, 2000).

<sup>84</sup> Alstott, *Work and Freedom*, at 977-987.

on poverty in the 1960s and 70s, and in the 1970s it was supplemented by a federal program to provide Food Stamps to the needy. However, as welfare was expanding, it also began to lose political support. By the 1980s and 90s, American values had shifted considerably, so that the goal of keeping women out of the labor force in order to raise children was no longer palatable to large numbers of the population. Rather, women who were on welfare were stigmatized, seen as lazy, opportunistic, or simply caught in a cycle of dependency. By the mid-1990s, political support had evaporated for "welfare as we know it."<sup>85</sup>

In 1996, Congress repealed AFDC and replaced it with the Personal Responsibility and Work Opportunity Act, which established a program called Temporary Aid for Needy Families, or "TANF." TANF rejected the premise that public assistance should be a source of long-term support for the needy, and instead adopted the premise that it should be a transition into the labor force. Accordingly, TANF places a five year lifetime time limit for an individual receiving federal welfare, and requires states to pressure recipients to find work. The program operates through block grants to the states and gives them wide discretion about how to structure their welfare programs.<sup>86</sup> Under TANF, states have broad discretion to decide who is eligible for benefits and in what amount. However, states are prohibited from giving federal assistance for any individual beyond 60 months. In addition, states are required to demonstrate that they are attempting to move beneficiaries who have been collecting benefits for 24 months into work activities. The states face fiscal penalties if they fail to meet specified targets set for the percentage of recipients participating in a work or work-related activity. Thus, under TANF, public assistance is no longer a universal program of aid to the poor. Rather, it is a time-limited safety net for those who fall outside the labor market, to tide them over and help them get back in.<sup>87</sup>

Anne Alstott argues for a return to an outright cash grant program. She terms TANF "unconscionable" for imposing a work requirement and a time limit on welfare recipients. She argues that both the nonworking and the working poor would fare better under a system of unconditional cash grants or an negative income tax than they would under a redistributive

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<sup>85</sup> See Michael B. Katz, *THE UNDERSERVING POOR: FROM THE WAR ON POVERTY TO THE WAR ON WELFARE* 66-69 (Pantheon, 1989). For an excellent overview of AFDC and discussion of criticisms of such programs, see Rebecca Blank, *IT TAKES A NATION*, supra. at 133-177. For an account for the waning political support for cash assistance in the 1980s and 90, see Blank at 123-126.

<sup>86</sup> Pub. L. No. 104-193 (1996).

<sup>87</sup> See Mark Greenberg, *Welfare Restructuring and Working-Poor Family Policy*, in Joel H. Handler & Lucie White, eds., *HARD LABOR: WOMEN AND WORK IN THE POST-WELFARE ERA* 24 - 32 (M.E. Sharpe, 1999).

program that requires participation in the labor market, such as the EITC or the employment subsidy proposals. Her argument is that cash grants give the working poor a choice as to how to allocate their time between work and leisure. With a cash grant, a low wage earner can choose to enhance her standard of living by working full-time, or choose to live frugally and not work at all, or strike some balance in between. According to Alstott, this kind of choice is an important aspect of freedom. For example, a cash grant would give a mother the freedom to choose to forgo earnings in order to spend time with her children while her children were young, choice that employment subsidy denies.<sup>88</sup>

There is, however, a serious problem with the outright cash assistance approach to income redistribution that Alstott does not address. Since the English Poor Laws if not before, public charity has been permeated with judgements about the moral character of the poor. Public charity has long distinguished between the worthy poor and the unworthy poor in determining how to distribute public largesse. This point was made comically in the long-running Broadway musical, *My Fair Lady*, when Eliza Doolittle's ne'er-do-well pauper father, Alfred Doolittle lectures Professor Henry Higgins on the plight of the *undeserving* poor. As Doolittle says, speaking from personal knowledge, the lazy, the drunks, and the ne'er-do-wells, unlike the deserving poor, receive neither charity nor sympathy from the public. In a more serious vein, social historian Michael Katz writes,

The undeserving poor have a very old history. They represent the enduring attempt to classify poor people by merit. This impulse to classify has persisted for centuries partly for reasons of policy. Resources are finite. Neither the state nor private charity can distribute them in unlimited quantities to all who might claim need. On what principles, then, should assistance be based? Who should – and the more difficult question, who should not – receive help?<sup>89</sup>

We see this distinction at work when victims of natural disasters and terrorist attacks are treated more generously derelicts and drug addicts.

The impulse to distinguish between the worthy from the unworthy poor frames modern welfare policies. For example, it is out of scepticism about the spending habits of the poor, that public and private charity efforts often involve the distribution of goods, such as food, shelter, or clothing, rather than distributions of cash. Because of an implicit moral judgment

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<sup>88</sup> Alstott, at 987-88.

<sup>89</sup> Michael Katz, *supra*. at 9. For a history of attempts to classify the deserving from the underserving poor prior to the twentieth century, see Katz, *supra*. at 11-16.

that the able-bodied poor are unworthy rather than merely unfortunate, public charity has usually been structured not only to provide subsistence to the poor, but also to change their behavior, beliefs and character. Hence public and private charities often couple assistance with intrusive inquiries into the private conduct of recipients. The requirements that the recipients of public relief perform work for their dole is justified not merely in instrumental terms, but also in moral ones. The working population has a deep resentment of those on welfare and it is a moral resentment, a belief that "I work, they should work too."<sup>90</sup>

Because of the history of moralizing and coercion that pervades outright cash assistance, it is a program that breeds mutual distrust and ill-will between the givers of assistance – i.e., the taxpayers – and the recipients – the needy. It fosters not social cohesion, but its opposite. As a result, political support for non-work based income redistribution has almost entirely evaporated. In this context, it is difficult to see how proposals for ameliorating income inequality by increasing cash assistance to the needy are likely to succeed.

In addition, it is not clear that the cash grant approach is ultimately beneficial to the poor. Unconditional cash grants create incentives for individual to stay out of the labor force. While they may be useful, indeed necessary, for certain limited periods to enable care-giving for children or aging parents, they are not a means to foster independence and dignity over the long term. In today's world, work plays a central role in one's sense of identity and connection to the larger world that cash assistance programs cannot deliver.

Katherine Newman, in *NO SHAME IN MY GAME*, paints a vivid portrayal of the way work creates personhood and paves the way to fulfillment in our society. She interviewed inner city youths in Harlem, New York who held jobs at a fast food hamburger establishment. She found that the jobs provided them with not only a regular source of income, but also self-respect, direction, a connection to the larger world, and a means to a richer life. For example, one black teenager girl, told her,

When I got in there, I realize it's not what people think. It's a lot more to it than flipping burgers. It's a real system of business. That's when I really got to see a big corporation at play. I mean, one part of it, the foundation of it. Cashiers. The store, how it's run. Production of food, crew workers, service. Things of that nature. That's when I

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<sup>90</sup> See Robert H. Haveman, *The Clinton Alternative to "Welfare as We Know It": Is it Feasible?* in D. Nightingale and R. Haveman, eds., *THE WORK ALTERNATIVE: WELFARE REFORM AND THE REALITIES OF THE JOB MARKET* 185, 194 (Urban Institute Press, 1995),

really got into it and understood a lot more."<sup>91</sup>

Newman found that in numerous respects, those in Harlem who have jobs inhabit a different world than those who do not. Job-holders not only have more money, they have more stability, develop a sense of responsibility, and become part of a social system that spans outward from the workplace to the larger community. "What they have that their nonworking counterparts lack is both the dignity of being employed and the opportunity to participate in social activities that increasingly define their adult lives. This community gives their lives structure and purpose, humor and pleasure, support and understanding in hard times, and a backstop that extends beyond the instrumental purposes of a fast food restaurant."<sup>92</sup> Newman concludes by observing that:

Our culture confers honor on those who hold down jobs of any kind over those who are outside the labor force. Independence and self-sufficiency – these are virtues that have no equal in this society. But there are other reasons why we value workers besides the fact that their earnings keep them above water and therefore less in need of help from government, communities, or charities. We also value workers because they share certain common views, experiences, and expectations. The work ethic is more than an attitude toward earning money – it is a disciplined existence, a social life woven around the workplace.<sup>93</sup>

If we understand work as producing not merely income but, as Newman's work vividly demonstrates, a means to personhood, then it makes sense to design public redistributive policies to further rather than hinder that goal. Public largesse is not infinite, so if our redistributive dollars are spent on unconditional cash grants, there will be little available to encourage labor market participation and assist the working poor. While Alstott characterizes the choice between employment-linked redistribution like wage subsidies and the EITC and unconditional cash grants as a choice between "work and freedom," it is equally possible to pose the choice as one between dignity and dependency. Dependency is not real freedom, but rather "the liberty of the outcast."<sup>94</sup> Viewed from that perspective, the employment-linked programs do not "lure people into the labor market," as Alstott contends, but are instead programs that

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<sup>91</sup> KATHERINE S. NEWMAN, *NO SHAME IN MY GAME* 103 (1999).

<sup>92</sup> *Id.* at 120-212.

<sup>93</sup> *Id.* at 119.

<sup>94</sup> Guy Standing, *GLOBAL LABOUR FLEXIBILITY: SEEKING DISTRIBUTIVE JUSTICE* 341 (McMillan Press, 1999).

offer individuals the opportunity to experience a richer and more meaningful way of life.

### ***B.II.3 Stakeholder Proposals***

A variation on the cash assistance proposal that avoids the political, historical and sociological pitfalls of cash assistance programs is the proposal for the state to establish a system of universal stakeholding. Bruce Ackerman and Anne Alstott, in the recent book, *THE STAKEHOLDER SOCIETY*, propose a program which would give every child in America a "stake" of \$80,000 upon reaching maturity. The stake could be used to finance a college or technical education, open a business, buy a home, or any other use that the individual chooses. If an individual uses it to finance a college education, they would receive it at age eighteen; otherwise they would have to wait until they reached age twenty-one. The only requirement for obtaining the stake would be the completion of high school and U.S. citizenship. Initially the stake would be paid with a 2 per cent tax on wealth. And those who receive a stake would be required to pay it back, with interest in their estate when they die. Thus while the initial federal outlays would be substantial, over time the repayments would accumulate in a fund to finance future stakes.<sup>95</sup>

Ackerman and Alstott argue that their stakeholder proposal would give young adults significant resources at a time when they most need resources to shape their economic prospects. Thus, they claim, it is a step toward providing equality of opportunity, comparable to the public education system that at one time represented a commitment to providing all children with the tools for building their futures. Ackerman and Alstott also argue the proposal helps to solidify a meaningful sense of citizenship by giving each citizen a concrete stake in his country. In this regard, they compare their proposal to the G.I. Bill that gave citizen-soldiers funds to start out in life.

In keeping with the goal of redressing inequality and at the same time creating a robust form of citizenship, Ackerman and Alstott also advocate that Social Security be transformed into a citizen pension rather than a pension linked to employment status. This way, they argue, the issue of old age financial security would express our society's "commitment to the ideal of a dignified old age," not to a particular role in the labor market.<sup>96</sup>

Ackerman and Alstott claim that their citizenship stakeholder proposal would help to equalize opportunity, and would partially overcome those

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<sup>95</sup> BRUCE ACKERMAN & ANNE ALSTOTT, *THE STAKEHOLDER SOCIETY*(Yale University Press, 1999).

<sup>96</sup> *Id.* at 140–54.

aspects of inequality that stem from inter-generational privilege.<sup>97</sup> While it would not affect relative incomes in the short run, it is a measure for equalizing opportunity over the long run.

### **B.III Assessing Non-Employment Linked Proposals for Redistribution**

While the foregoing proposals for cash assistance and universal stakeholding both involve redistributive measures that do not depend upon employment, they differ greatly in their ability to position people in the labor market. The cash assistance program is more a safety net than a redistributive measure – it would shore up the very bottom of the economic ladder without affecting the labor market directly. If the cash grant were sufficiently generous, it might make it more difficult for employers to obtain low wage labor and thereby indirectly exert an upward pressure on wages. However, neither Alstott nor others are proposing a cash grant large enough to do that. Thus the cash assistance proposals would create an alternative to the labor market rather than revise the distributive outcomes generated by the labor market.

The stakeholder proposal, on the other hand, does more than simply provide assistance to the poor. It endows individuals with tools they can use to play a meaningful role in society, whether through education, training, or entrepreneurial activity. And because the stake is a one-time grant to young adults, it does not create long-term disincentives to joining the labor force. Rather, it creates opportunities for those who otherwise would not have them. It does not discourage labor market participation but rather operates as an enabler of more widespread and robust labor market participation. The proposal is not directly redistributive -- it is available to all young adults, regardless of their means -- but because it is financed through a wealth tax, it would be redistributive at its funding source. In addition, because the proposed benefits are available to all without a means-test, it would encounter less political resistance than cash grant programs. For all these reasons, the stakeholder proposal is an approach to long-run inequality that has great promise. It addresses the mechanisms by which inequality is perpetuated, and thus presents a more fundamental solution to inequality than the proposals considered thus far.

### **B.IV Addressing Vulnerability in the Boundaryless Workplace**

All of the foregoing proposals have some potential for redressing the glaring income inequality that has arisen in the past twenty-five years by raising incomes of those at the bottom. Of the proposals discussed, the

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<sup>97</sup> ACKERMAN & ALSTOTT, THE STAKEHOLDER SOCIETY 24–34.

EITC, together with a rise in the minimum wage, seems to offer a promising approach to short-term redistribution, and the proposal for universal stakeholding, by enabling low wage workers to enhance their human capital at an early stage in their work lives, would be redistributive over time.

The proposals considered thus far involve after-the-fact adjustments to the operation of the current global labor market and dynamics of the digital era firm. None of the proposals will induce firms to generate more equalizing compensation practices in their day-to-day operations, none will reverse the trend toward more and more winner-take-all markets for talent, and none will directly assist workers as they navigate the tumultuous new world of work. There are, however, policies available that address the problem of inequality by addressing individuals' vulnerability in their role as workers.

This section will consider some recent U.S. policies that attempt to assist in labor market transitions -- worker training allowances, portability of benefit plans, publically provided child care. It will then discuss a European proposal that attempts to address the problem of increased worker vulnerability directly: the proposal for social drawing rights.

### **B.IV.1 New Approaches to Economic Transitions**

#### *a. Training*

A number of policies have been discussed and/or attempted in recent years that would help ease transitions necessitated by the boundaryless workplace. These include requirements for benefit portability, worker retraining accounts, and expanded federal funding for child care. In 1998, Congress enacted the Workforce Investment Act<sup>98</sup> (WIA), as a complement the Personal Responsibility and Work Opportunity Reconciliation Act of 1996 that ushered in welfare reform. The WIA provides federal funds for states to establish "career centers" that are to be one-stop delivery systems for the unemployed and job seekers. These One-Stop career centers administer unemployment insurance but they also do a lot more. They provide a clearing house for job placement services, offer job training information, provide computer training and run workshops on resume writing, and offer free faxing and Internet access. They also provide information on labor market trends, the availability of training providers, and evaluations of local training options. According to Linda Angello, New York State's Labor Commissioner. "We've been working hard to change our image from the unemployment people to the

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<sup>98</sup> 29 U.S.C. § 2801 (West 2000).

employment office. There's been a change in philosophy and a change in the way we do business."<sup>99</sup>

Under the Act, localities are required to establish a Workforce Investment Board comprised of local employers to match the One-Stop career services to the local job market. WIA also provides funds for Individual Training Accounts (ITAs) for workers who require job training.<sup>100</sup> Training can include occupational skills training, one-the-job training, cooperative education, private sector training, skill upgrading and retraining, entrepreneurial training, job readiness training, and adult education and literacy activities.<sup>101</sup>

At present, most cities are in the process of establishing One-Stop centers. New York City opened a One-Stop center in Queens a year ago, and plans five more in the next two years. Los Angeles has opened 18 centers, Chicago has 17, and San Francisco has only three. In Austin, Texas, three One-Stop centers and four satellite offices have been established. These centers have utterly transformed the old employment offices, which used to be primarily surveillance mechanisms to ensure that recipients were able, available and actively searching for work, more like a parole office than a place to get assistance. The new centers offer job search facilities and counseling that are not only attuned to the local labor market, but also to the local populations. Large city centers are offering service in many languages to deal with their diverse populations. Their services are designed to provide assistance in finding employment at all levels, including offering workshops on self-employment. One worker, a former CNN employee laid off last May, said of her experience with the Queens One-Stop, "My experience was remarkable. I was very impressed. They treated us like professionals rather than problems."<sup>102</sup>

One commentator has criticized the program for its over-reliance on the principle of consumer choice.<sup>103</sup> Under the statute, individuals are given vouchers to pay for training on the theory that it will help create a market based system for training services. Nan Ellis is critical of the use of vouchers for job training on the grounds that job-seekers too often cannot make informed choices about either their labor market prospects or about the quality of the training options available to them.<sup>104</sup> Instead,

<sup>99</sup> Susan Saulny, *New Jobless Centers Offer More Than a Benefit Check*, THE NEW YORK TIMES, September 5, 2001, page A-1.

<sup>100</sup> For a description of the Workplace Investment Act, see Nan Ellis, *Individual Training Accounts Under the Workforce Investment Act of 1998: Is Choice a Good Thing?* 8 Geo. J. on Poverty Law and Policy 235 (2001).

<sup>101</sup> 29 U.S.C. 2864 (West, 2000)

<sup>102</sup> Saulny, *supra.*, NEW YORK TIMES, September 5, 2001 at B-6.

<sup>103</sup> Ellis, *Individual Training Accounts, supra.*, 8 Geo. J. on Poverty Law and Policy 235, 241.

<sup>104</sup> *Id.* at 251-52.

she suggests that there be additional mechanisms to ensure that the centers provide job-seekers with reliable information about the training opportunities, in readable and comprehensible form, together with critical evaluations of each one, and that job counselors be trained to help job-seekers select appropriate training options.

While the WIA is quite new, and One-Stop centers are just being established in most locations, it is a program that could help workers weather career transitions. If the One-Stop centers do ensure informed and reasoned choice amongst job-seekers, they have the potential to be effective mechanisms for dealing with the vicissitudes of the boundaryless labor market. If they were funded at a level that enabled them to offer significant and on-going training programs for all that wanted them, and if they included local unions and community groups on their Workforce Investment Boards, they would begin to resemble the Worker Retraining and Upskilling Centers advocated in Chapter 10, above.

*b. Child Care*

In addition to the WIA, there have been some expanded support for child care as part of the work-to-welfare programs established under the Personal Responsibility and Work Opportunity Act. A 1996 enactment established the Child Care Development Block Grant, to consolidate four federal programs that made funds available for child care for AFDC recipients moving into the workforce and for certain other low-income working families. The new program gives block grants to the states to establish and design their own child care programs. The program is poorly funded – about \$3 billion – but the law permits states to use some of their TANF funds for child care as well.<sup>105</sup>

These programs do not go nearly far enough. Lack of affordable quality child care is a major impediment to full labor force participation for women. The new welfare philosophy that mandates workforce participation cannot succeed without providing the necessary infrastructure of child care. Adequate child care is necessary for women throughout the income distribution, but especially for those at the bottom. When women are forced to miss work to stay home with a sick child, or leave work early to attend doctor's appointments, and when women are forced to fill gaps for school holidays and snow days, they are penalized in the labor market. The new workplace requires flexibility on the part of employees but it does not promise them flexibility in return. Without reliable child care, women are not only penalized in the old-

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<sup>105</sup> See Mark Greenberg, *Welfare Restructuring and Working-Poor Family Policy: The New Context*, in J. Handler and L. White, eds., *HARD LABOR* 24, 33-34 (1999).

fashioned days for missing days or coming in late, they experience new types of penalties as well. Women with children are often unable to take advantage of after-hours training opportunities, unable to engage in informal networking in bars and cafes after work, and are less available for travel. Even though some enlightened employers are willing to give employees flex-time or make other accommodations, without funded and reliable child care, women workers will always be living on the edge and sometimes falling off.

Child care needs to be understood as part of the social infrastructure required for our economic system to operate. One we abandoned a cash grant approach to welfare and chose instead to encourage work, then we became obligated to ensure that the preconditions for women's participation in the workforce are in place. We finance a public education system in order, in part at least, to enable individuals to be productive members of society, and we provide a system of junior colleges and adult education programs to provide lifetime learning possibilities. For the same reasons, we need to finance adequate child care.

### *c. Benefit Portability*

The boundaryless workplace is not a frictionless one. When workers cross boundaries between firms, they often pay a cost in terms of insurance protection. In the United States, most forms of social insurance are employer-centered. The federal government mandates old age assistance and provides some insurance against disability and accidental death through the social security program. In addition, states provide insurance against workplace injury in the workers compensation systems and insurance against unemployment through their unemployment insurance programs. However, these programs provide bare bones programs at best. Thus since the mid-twentieth century, most American workers looked to their employer for medical insurance, long-term disability insurance and meaningful pension coverage. For a complex set of reasons that included good actuarial practices, avoidance of adverse selection, and the desire to encourage worker loyalty and attachment, most employer-sponsored benefit plans have been structured to bind the worker to the firm. Thus, for example, until the 1980s, most pension plans were defined benefit plans, with long vesting periods and back-loaded benefit formulae. These plans encouraged long-term service and penalized workers who were mobile. Similarly, most health insurance plans had waiting periods and exclusions for pre-existing conditions, features that made it risky for a worker to change jobs. In the boundaryless workplace, in which workers change jobs frequently, benefit

portability has become an urgent problem.

There have been modifications to the laws and practices governing pensions and health insurance in the past two decades that address the issue of portability. First, in the area of pensions, there has been a general shift to from defined benefit plans to defined contribution plans. The latter are inherently more portable because the benefits continue to accumulate in the employees account until she reaches retirement, no matter where she works. Sums accrued in defined benefit plans, on the other hand, are forfeited if an employee leaves before her benefits vest, and are frozen in amount if she leaves after they have vested. Second, in the Employee Retirement Security Act of 1974 ("ERISA") Congress set a maximum vesting period of ten years and, in 1986, lowered the maximum for defined contribution plans to five. Prior to 1974, most plans had no vesting period, so all benefits were forfeited if an employee left the employer.

Third, in 1992, Congress expanded the situations in which employees who changes jobs could "roll over" assets accumulated in their accounts to a new plan without incurring taxes or penalty liability. This change was applicable to defined contribution plans, enhancing their portability.

Fourth, since the late 1970s, Congress has expanded the possibilities for individuals to engage in individual tax-preferred retirement savings, through expanding the use of IRAs, providing for 401(k) plans, providing for medical and Roth IRAs (for educational savings), and establishing other such mechanisms. And finally, the recent move to cash balance plans and other hybrid plans is a move that increases portability for younger and mobile workers, although the process of conversion can have catastrophic effects on older, long-term workers.<sup>106</sup>

In addition, in the health insurance area there has also been some movement toward greater portability. In 1985, Congress enacted the Consolidated Omnibus Budget Reconciliation Act (COBRA) that requires employers who have health insurance plans to offer departing beneficiaries the opportunity to continue their coverage for 18 months. While employees are generally required to pay for their COBRA coverage themselves, it nonetheless means that they do not lose their health insurance when they terminate employment. In 1996, Congress further expanded portability with enacting the Health Insurance Portability and Accountability Act (HIPAA). HIPAA requires group plans to reduce waiting

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<sup>106</sup> For an excellent discussion of the barriers to portability in pension and health insurance plans, and recent changes to make plans more portable, see Katherine Ulrich, *You Can't Take It With You: An Examination of Employee Benefit Portability and its Relationship to Job Lock and the New Psychological Contract*, in \_\_\_\_ Hofstra J. of Labor and Employment \_\_\_\_ (2001) [forthcoming].

periods for pre-existing conditions when employees move from one health plan to another. It also raised the tax deductability of health insurance premiums for individuals who were self-employed. These provisions make it easier for an individual to retain health coverage as they move between workplaces.

Despite these recent changes, benefits are not yet fully portable, and thus remain an impediment to individuals who have peripatetic work lives. Some proposals to further increase pension portability include the total elimination of vesting requirements, requiring service credit transfer when a participant moves between employers, and expanding the ability of employees to use IRAs. Another approach is to encourage the formation of multi-employer pension plans that operate on a regional basis in which all employees in a locality can participate. This kind of community-based pension plan could be sponsored by a geographically-based citizen union, of the type discussed in Chapter 10. Alternatively, converting social security into a citizen's pension and increasing its amount, as Ackerman and Alstott propose, would provide near-perfect pension portability.

In the area of health insurance, portability could be increased by national health insurance, but that option seems beyond political reach. Another measure that would to enhance portability would be an amendment to the Internal Revenue Code to permit full deductions for individuals for the cost of health insurance premiums. This change would permit individuals to select their own health insurance plan and thus side-step the employer-sponsored plan altogether.<sup>107</sup>

The programs described above for job training, child care, and benefit portability together have the potential of helping enable individuals to participate in the new labor market in a meaningful way. They work in conjunction with programs like the EITC and the minimum wage to alleviate some of the problems that stand in the way of success in the boundaryless workplace. But like the EITC and the minimum wage, they need to be expanded in scope and funding in order to realize their full potential. Even then, however, they cannot ensure success for everyone – the new workplace presents new challenges and will generate a new mix of winners and losers. Those who are not flexible, who have personal situations or personality traits that lead them to require stability, certainty, and routine, will not fare well. The proposal for universal stakeholding would provide some measure of assistance to permit individuals, at a crucial time in their life-cycle, to start with a solid

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<sup>107</sup> This proposal is put forward by Marina v.N. Whitman, *NEW WORLD, NEW RULES: THE CHANGING ROLE OF THE AMERICAN CORPORATION* 174-75 (Harvard Business School Press, 1999).

foundation. All these measures are a far cry from the old safety net of AFDC and general relief. Yet they have the potential for providing a new kind of safety net – a safety net of empowerment and opportunity for change, rather than a safety net of minimal subsistence and stasis.

#### ***B.IV.2 The European Proposal for Special Drawing Rights***

A very different approach to the problems of inequality and vulnerability flexibility has emerged in Europe. In 1996, the European Commission convened a group of labor relations experts to consider the impact of changes in the workplace on labor regulation in Europe. The group, of which Alain Supiot was the chair, studied the changing industrial relations practices in Europe and in 2000 issued its report, known as the Supiot Report. The Report describes a changing employment landscape in Europe that mirrors changes I have described in the United States -- a movement away from industrial era job structures toward more flexible industrial relations practices. It finds that the new work practices have entailed a loss of job and income security for European workers. The Report calls for new mechanisms to provide workers with “active security” by which they mean mechanism that equip individuals to move from one job to another. They contrast this need for active security from the welfare type of security of the past:

Rather than making welfare a type of compensation made available after supposedly unavoidable economic damage has been done, it should be turned into something which gives individuals and intermediary groups their own resources, which, in turn, will enable them to equip themselves with active security to cope with risks. . . . It therefore follows that security in the form of guarantees of a minimum standard of life, as traditionally provided by social security systems, has to be supplemented, because of the need for economic flexibility, by the objective of shaping, maintaining, and developing people’s competencies during their lifetimes.<sup>108</sup>

The Supiot Report contains a number of suggestions for changes in the institutions regulating work to provide active security. Their most visionary, and most controversial, proposal is for the a creation of “social drawing rights” to facilitate worker mobility and to enable workers to weather transitions. The concept of social drawing rights is derived from existing arrangements in which workers have rights to time off from work for specified purposes such as union representation, maternity leave, and so forth. The report makes an analogy to sabbatical leaves, maternity

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<sup>108</sup> Alain Supiot, *BEYOND EMPLOYMENT* 197 (Oxford University Press, 2001).

leaves, time off for union representatives and training vouchers to observe that “we are surely witnessing here the emergence of a new type of social right, related to work in general.”<sup>109</sup>

Under the proposal, an individual would accumulate social drawing rights on the basis of time spent at work. The drawing rights could be used for paid leave for purposes of obtaining training, working in the family sphere, or performing charitable or public service work. It would be a right that the individual could invoke on an optional basis to navigate career transitions, thereby giving flexibility and security in an era of uncertainty. As Supiot writes, “They are *drawing* rights as they can be brought into effect on two conditions: establishment of sufficient reserve and the decision of the holder to make use of that reserve. They are *social* drawing rights as they are social both in the way they are established . . . and in their aims (social usefulness).”<sup>110</sup>

The purpose of the social drawing rights is to enable all individuals the flexibility to take time away from the workplace in order to manage transitions and build human capital. This approach responds to the new conditions of work lives, in which careers unfold in unpatterned ways and require an individual to operate both inside and outside the formal labor market at different and unpredictable times. Social drawing rights would smooth these transitions and give individuals the resources to retool and to weather the unpredictable cycles of today’s workplace. Like the Ackerman-Alstott proposal for stakeholder grants, it would be an equalizing measure not because it is overtly redistributive but because it would help to equalize opportunity. Like the Ackerman-Alstott proposal for stakeholder grants, the proposal for social drawing rights would be a social investment in the ability of all to participate as equals in the emerging economic order.

The Supiot Report does not specify in detail how the social drawing rights would be funded, other than to suggest that they be funded by a combination of contributions from the enterprise, the state, social insurance funds, and perhaps individual savings. The question of funding may not be a major concern in Europe because most European countries already make substantial expenditures on social welfare that could, at least theoretically, be redeployed in this fashion. But to transpose the

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<sup>109</sup> Id. at 56.

<sup>110</sup> See Alain Supiot, et. al., *BEYOND EMPLOYMENT* 56 (Oxford Press, 2001); Alain Supiot, et. al., *A European Perspective on the Transformation of Work and the Future of Labor Law*, 20 *Comp. Lab. L. & Pol. Jo* 621628 (1999). See also, David Marsden & Hugh Stephenson, *Discussion Paper, Labor Law and Social Insurance in the New Economy: A Debate on the Supiot Report*, Centre for Economic Performance, (London School of Economics, July 2001).

idea of social drawing rights to the United States would require a major reorientation in our social policy.

In the United States, we have precedents for the concept of paid time off with reemployment rights to facilitate career transitions or life emergencies. There are well established precedents for paid leaves for military service, jury duty, union business, and other socially valuable activities. Some occupations also offer periodic sabbatical leaves. The concept is also built into the idea of temporary disability in state workers compensation and other insurance programs, which provide compensation and guarantee reemployment rights for temporary absences. The recent Parental Leave Act extends the concept of leave time to parenting obligations, although it does not mandate that such leave time be compensated. These programs all reflect and acknowledge the importance of subsidized time away from the workplace to facilitate a greater contribution to the workplace. They could serve as the basis for developing a more generalized concept of career transition leave.

Like the stakeholder proposal, the proposal for social drawing rights an innovative policy proposal to date that is directly responsive to the needs of individuals in the face of the changing workplace. It has the potential to realize the ideal of freedom while at the same time equalizing opportunity, creating conditions of success, and reinforcing the central role of work in our lives. For these reasons, it deserves to be taken seriously on both sides of the Atlantic.

June, 2002