

Failing on Two Fronts: The U.S. Labor Market Since 2000

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Acknowledgements

CEPR thanks the Public Welfare Foundation and the Ford Foundation for financial support. The author thanks Janine Duffy for research assistance, and Eileen Appelbaum, Dean Baker, and participants at conferences organized by CEPREMAP/DARES on “European and American Labor Markets in Crisis” and UNICAMP on “Work in Brazil: A Comparative Perspective” for many helpful comments.

Introduction

For almost four decades and by almost all available measures, economic inequality has been increasing in the United States. For a portion of this period, the United States could console itself, in part, by celebrating its success as a “jobs machine.” Indeed, the two issues were often linked in the standard economics account of the post-Reagan era: widening wage inequality rewarded the skills of those at the top, while providing job opportunities for those at the bottom. In countries where inequality did not increase, the story went, employment suffered.¹ But, for almost 15 years, that story has not held. The U.S. jobs machine has broken down. The employment-to-population rate at the peak of the business cycle in 2007 was substantially lower than it had been at the peak of the preceding business cycle in 2000. The employment rate has barely increased in the five years since the official end of the “Great Recession” in the summer of 2009. And almost the entirety of the decline in the unemployment rate since 2010 is the result of workers giving up on job search rather than finding new jobs.

The long-standing rise in inequality, now joined by an extended period when the economy has been unable to generate jobs for the country's growing population, constitutes a deep failure on two fronts: steeply rising inequality combined with a poor employment performance. This paper argues that a key driver of both of these developments is conscious economic policy, with a particularly important and under-appreciated role for macroeconomic policy. The paper first demonstrates the remarkable “flexibility” of U.S. labor markets relative to the situation in other rich economies. The paper then links this policy-induced flexibility to high and rising inequality and shows that such flexibility ceased long ago to contribute --if it ever did-- to greater job creation.

The recent experience of the United States stands as a sober warning for European economies seeking to escape from their own immense employment problems. U.S. labor markets operate with a degree of flexibility that lies well outside the current standard in every European economy and, more importantly, outside what is likely to be politically possible anywhere in contemporary Europe. If U.S. levels of flexibility have not prevented the derailing of the U.S. jobs machine over the last 15 years, more modest reforms in more regulated economies are not likely to fare especially well either. Meanwhile, for the United States, the experience of the last decade and a half strongly suggests the importance of paying more attention to macroeconomic issues, in particular, traditional macroeconomic stimulus in the short term and large-scale demand-side strategies, from

1 Even prominent liberal economists such as Paul Krugman adhered to this view in the 1990s; see, for example, <http://www.pkarchive.org/economy/TechnologyRevenge.html>. For longer critiques of this position, see, among many others, Howell (2004) and Howell, Baker, and Schmitt (2007).

infrastructure investment to universal child-care, in order to sustain aggregate demand in the face of “secular stagnation.”²

The “Flexibility” of U.S. Labor Markets

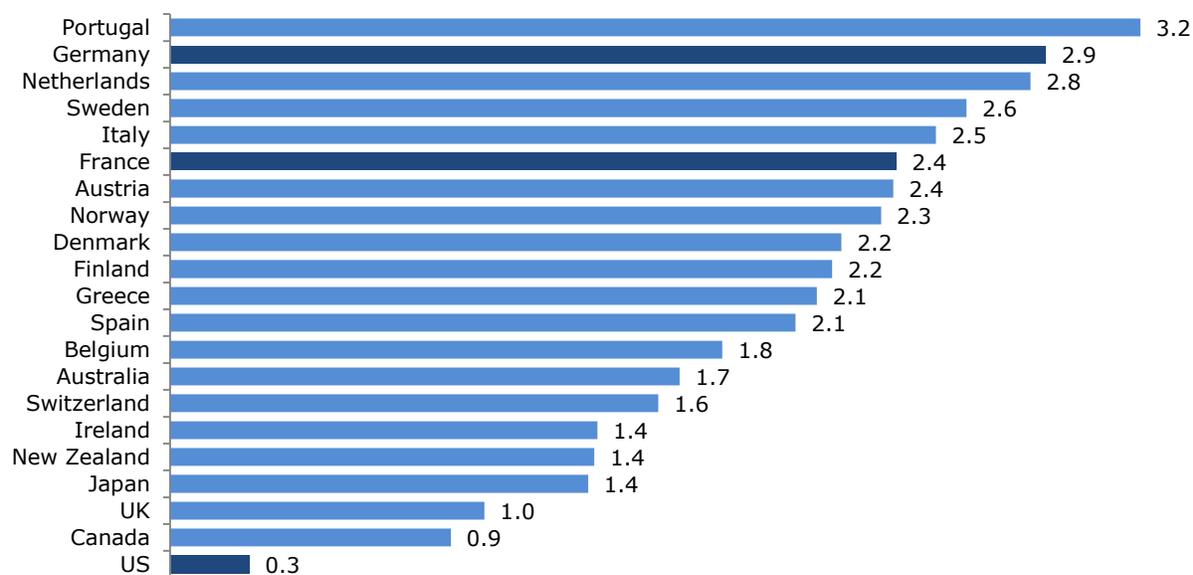
Compared to the other rich economies that form the core of the Organization for Economic Cooperation and Development (OECD), the United States has a very “unregulated” or “flexible” labor market. A few examples will illustrate.

First, workers in the United States have almost no legal job security. It is very easy to fire workers in the United States --even regular, full-time employees with many years of job tenure. U.S. law does not require any provision for advanced notice of a dismissal (except in limited cases where enforcement is rare and penalties for non-compliance are low). Nor is there a requirement in U.S. law for severance pay of any kind. Labor law does not even require that employers provide a reason or justification for dismissals. **Figure 1** displays OECD data that gives some idea of how the United States compares with other countries. Based on the OECD's estimates of the strictness of national employment protection legislation for regular employment, France scores a 2.4. Germany is a bit stricter, at 2.9, and the United States has the lowest score in this group, at 0.3.

FIGURE 1

Strictness of Employment Protection - Individual and Collective Dismissals (Regular Contracts)

OECD Scale 0-6



Source: OECD

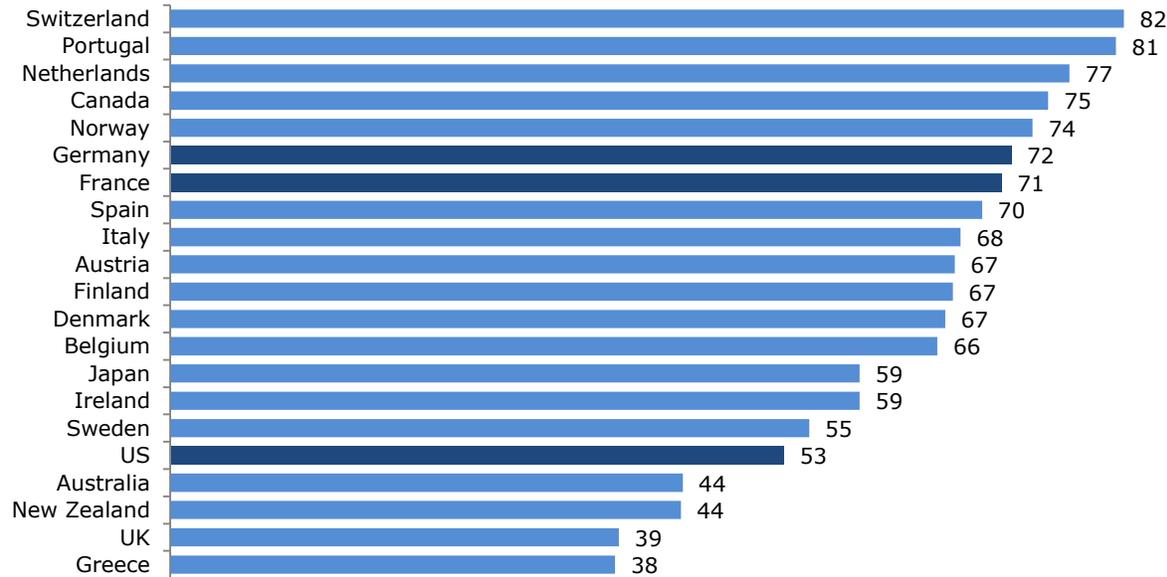
2 On secular stagnation, see, for example: Summers (2014).

A second example of U.S. flexibility is the U.S. unemployment insurance system. When a worker does lose his or her job, unemployment insurance benefits are fairly stingy. According to OECD estimates in **Figure 2**, unemployed French and German workers, for example, can expect to receive benefits equal to about 70 percent of their salary. In the United States, workers lucky enough to receive unemployment benefits generally receive only a bit over half of the salary they lost. In 2014, fewer than one in three unemployed workers actually received unemployment benefits.³

FIGURE 2

Generosity of Unemployment Insurance, 2012

Net replacement rate, percent



Source: Author's analysis of OECD data.

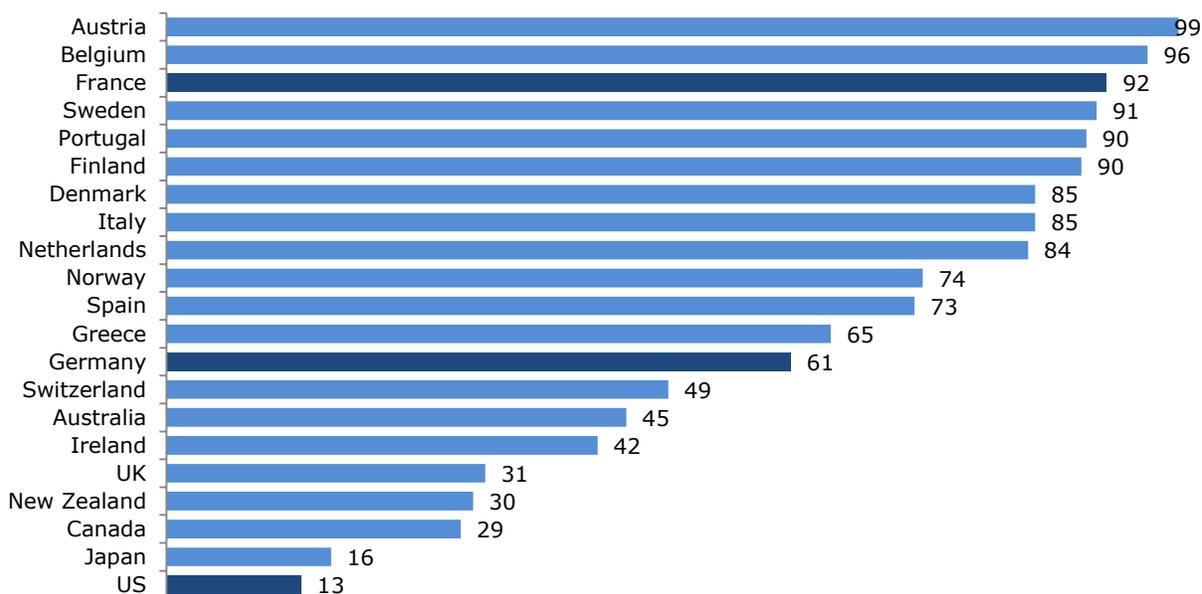
A third example is the small share of the U.S. workforce that is covered by a collective bargaining agreement. As **Figure 3** demonstrates, the United States is the least unionized of the core OECD countries, with only 13 percent of workers covered by a union contract. The unionization rate in the U.S. private sector (which is not shown in the chart) is particularly low, on the order of about 7 percent of workers.⁴

3 Bivens (2014).

4 BLS (2014), Table 3.

FIGURE 3**Collective Bargaining Coverage, 2012**

Percent of workforce



Source: Visser, accessed September 15, 2014.

A similar story holds for host of additional indicators, including: the regulation of working time (the United States has no legal requirement for paid parental leave, paid annual leave, or paid sick days, for example); the minimum wage (the federal minimum wage is low relative to the median wage); or taxes on labor.⁵

In short, the United States has a level of “flexibility” that is far beyond anything currently obtained in most of the core OECD countries and, arguably, beyond anything that would be politically possible in the foreseeable future in most European countries.

High and Rising Inequality

One direct consequence of this degree of labor-market flexibility is a high and rising level of economic inequality. Even economists who believe that “skill-biased” technology is the main force behind rising inequality recognize that labor-market institutions such as unions and the minimum wage can help to reduce inequality. But, these same economists generally also believe that the cost of

5 On paid parental leave, see Ray, Gornick, and Schmitt (2010); on paid sick days, see Heymann, Rho, Schmitt, and Earle (2010); on paid annual leave, see Ray, Sanes, and Schmitt (2014); on the minimum wage, see OECD, “Minimum wages relative to median wages,” <http://is.gd/WkoMaL>; on taxes on labor, see OECD “Taxing Wages: tax burden on labour income in 2013 and recent trends,” <http://is.gd/4WOObCK>.

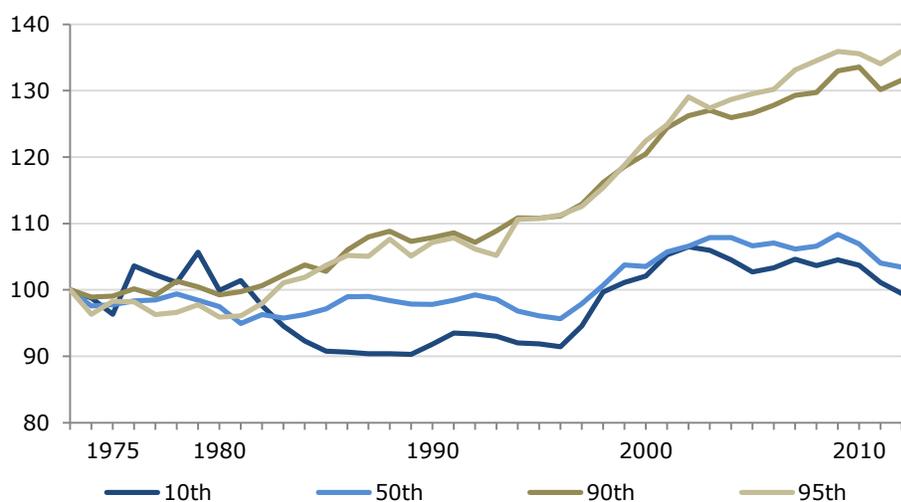
the resulting reduction in inequality is some degree of lower employment, particularly for less-skilled workers.

A quick review of the scale and timing of U.S. economic inequality is helpful. **Figure 4** presents the growth in real wages for U.S. workers at the 10th, 50th, 90th, and 95th percentiles, from 1973 through 2012, based on an analysis of Current Population Survey data by the Economic Policy Institute. Several features stand out. First, wages grew much more at the top of the wage distribution (90th and 95th percentile) than they did at the middle (50th percentile) and the bottom (10th percentile). Second, real wage growth was negligible or even negative for large swaths of the distribution. At the 10th percentile, real wages were lower in 2010 than they had been in 1979 and at the median, wages were up less than 10 percent in more than three decades. Finally, for most workers, the only period of real wage growth coincided with the period of sustained low unemployment that began in about 1996.

FIGURE 4

Real Wage Growth, Wage Percentile, 1973-2012

Real wage, 1979 = 100



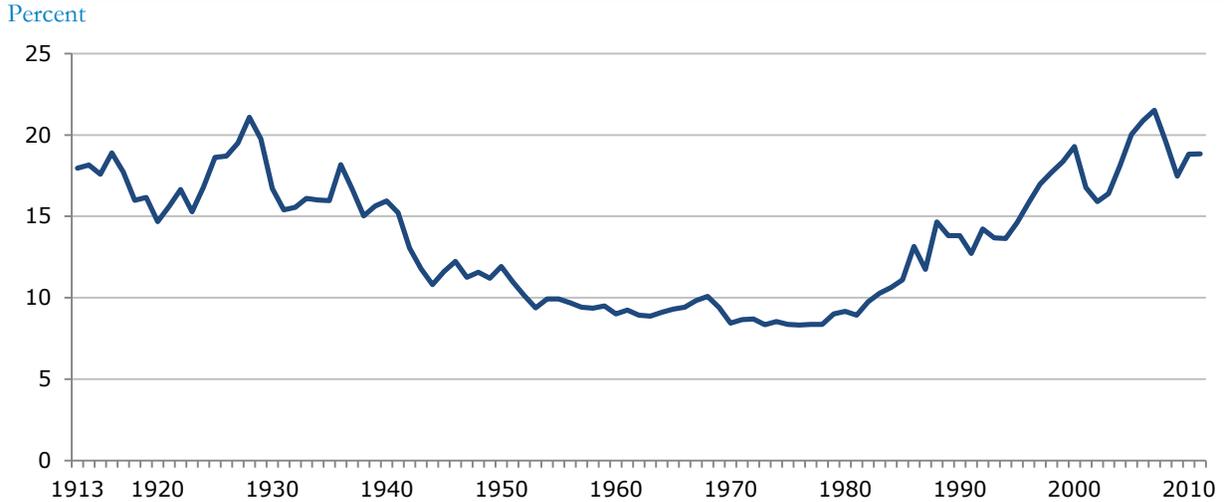
Source: EPI analysis of CPS data.

The rise in economic inequality was not limited to wages. **Figure 5** shows the academic chart made famous by Occupy Wall Street: the share of total income going to the top one percent, as calculated by economists Thomas Piketty and Emmanuel Saez (2003).⁶ The feature of this graph that has received the most attention is the steep increase inequality from the late 1970s to the present. But, I would emphasize that the chart also shows economic inequality was falling or flat during the five preceding decades. High and rising income inequality are apparently *not* inherent features of the U.S. economy.

⁶ Updated regularly at Emmanuel Saez's web page: <http://eml.berkeley.edu/~saez/>.

FIGURE 5

Share of Income to Top 1%, United States, 1913-2011

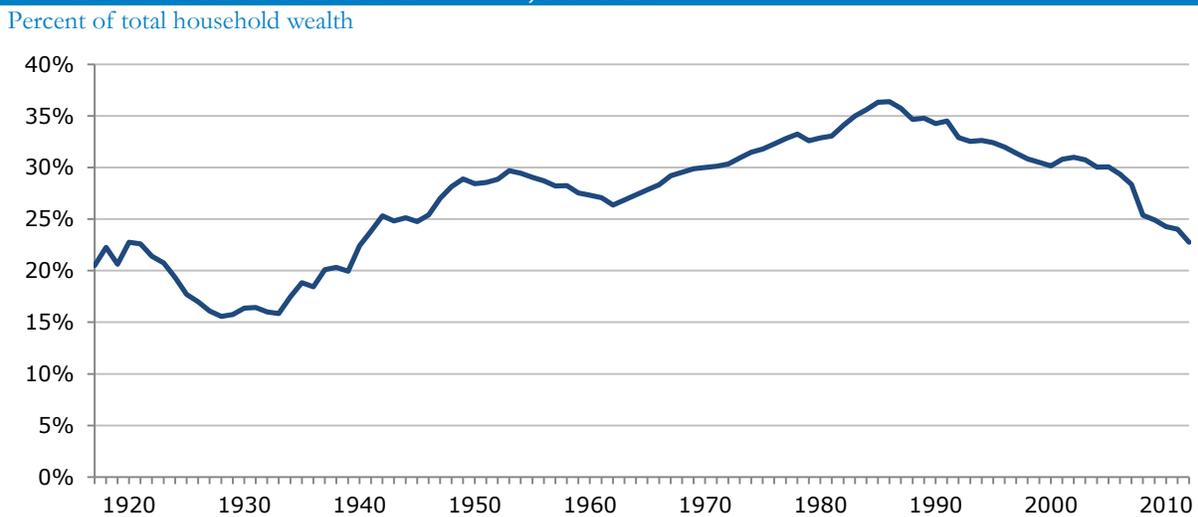


Source: Piketty and Saez.

We see a similar pattern when we look at the wealth distribution. **Figure 6** is a chart taken from recent research by Emanuel Saez and Gabriel Zucman (2014). The Saez and Zucman data paint a stark picture of wealth inequality in the United States, with high and rising inequality after the early 1980s. At its peak, the bottom 90 percent never held more than about one-third of total wealth; in the most recent data, the share is below one-fourth. But, as with the Piketty and Saez graph of income inequality, these data show wealth inequality falling for five decades from the 1930s through the 1970s, suggesting that it is possible for wealth inequality to fall even when the economy grows as rapidly as it did in the early postwar period.

FIGURE 6

Bottom 90% Wealth Share in the United States, 1917-2012



Source: Saez and Zucman (2014).

The Broken U.S. “Jobs Machine”

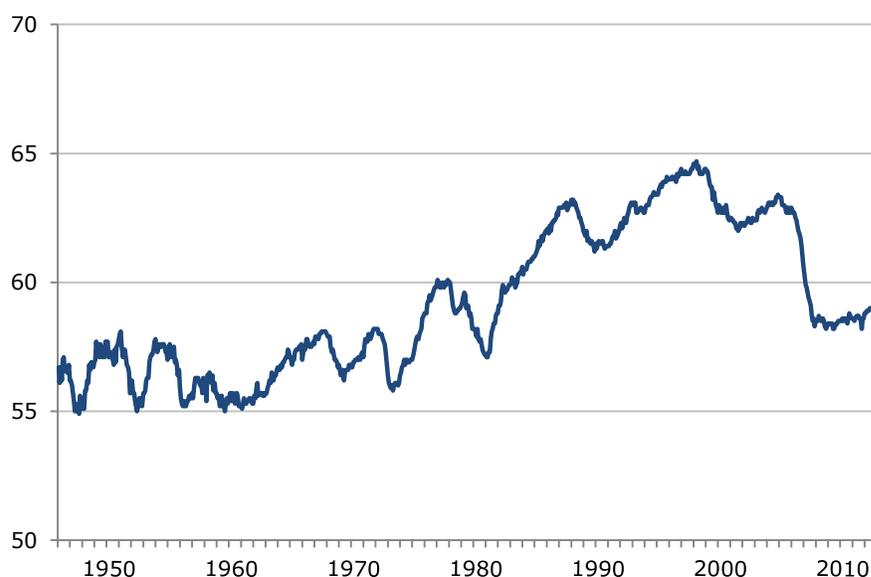
The preceding data on rising inequality are well-known. What is less well-known and certainly less appreciated in academic and policy debates is that the U.S. economy appears to have lost its previous standing as a veritable “jobs machine.” Importantly, this poor employment performance is not simply a problem of the Great Recession, but seems to have started at least as early as 2001.

Figure 7 shows the employment-to-population rate for the United States from 1948 to 2014. I want to point out three distinct periods. During the first, from the 1970s until about 2000 --with cyclical ups and downs-- the overall employment rate grew strongly. In the second period, coinciding with the recession of 2001 and running through the business cycle peak in 2007, overall employment performance was poor. In fact, the employment rate never recovered its 2000 peak before the new recession started at the end of 2007. The final period is, of course, the one that starts with the Great Recession, when employment rates fell off a cliff after 2008 and have not moved much since the recovery officially began in the summer of 2009.

FIGURE 7

Employment-to-population Rate, United States, 1948-2014

Percent



Source: Bureau of Labor Statistics

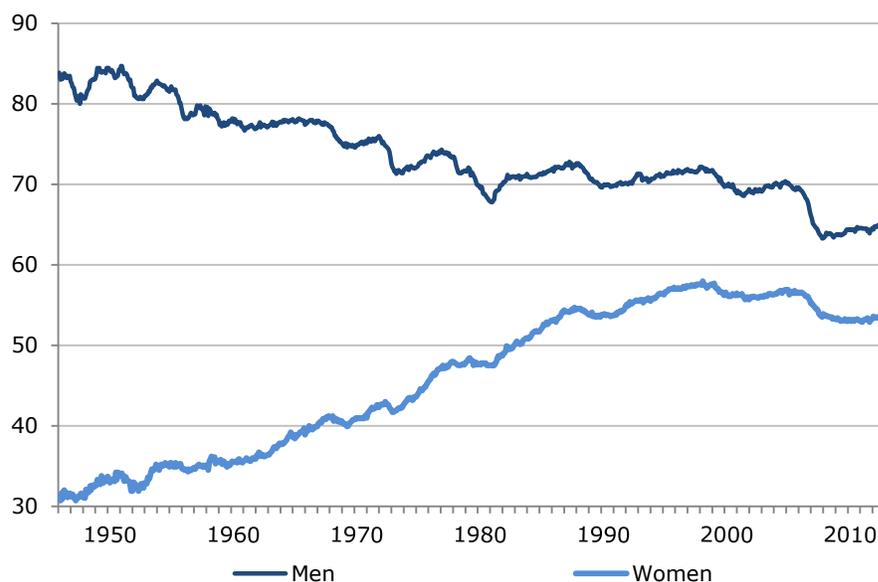
Figure 8 gives a breakdown of the overall employment rate by gender. The patterns for men and women are markedly different and complicate our understanding of the slow-motion crisis. For men, employment-to-population rates show a gradual decline from the end of World War II through about 1980. Much of this decline was for good reasons: among the young, an increased participation

in high school and college; and, among older workers, earlier and longer retirements. From the early 1980s through 2000, however, male employment rates roughly held their own. After 2000, male employment rates resumed their decline, with an especially sharp drop after 2007.

FIGURE 8

Employment-to-population Rate, United States, 1948-2014

Percent



Source: Bureau of Labor Statistics

Meanwhile, the employment path for women shows a very different pattern. Employment rates for women rose fairly smoothly from the 1950s through the late 1990s, but have been flat or falling ever since. A key implication of these diverging lines for men and women is that *all of the net increase in the overall U.S. employment rates in the postwar period is due to an increase in employment rates of women*. A key concern raised by these same two lines is that the increase in women's employment rates appears to have ended sometime in the late 1990s and may even have started to reverse itself.⁷

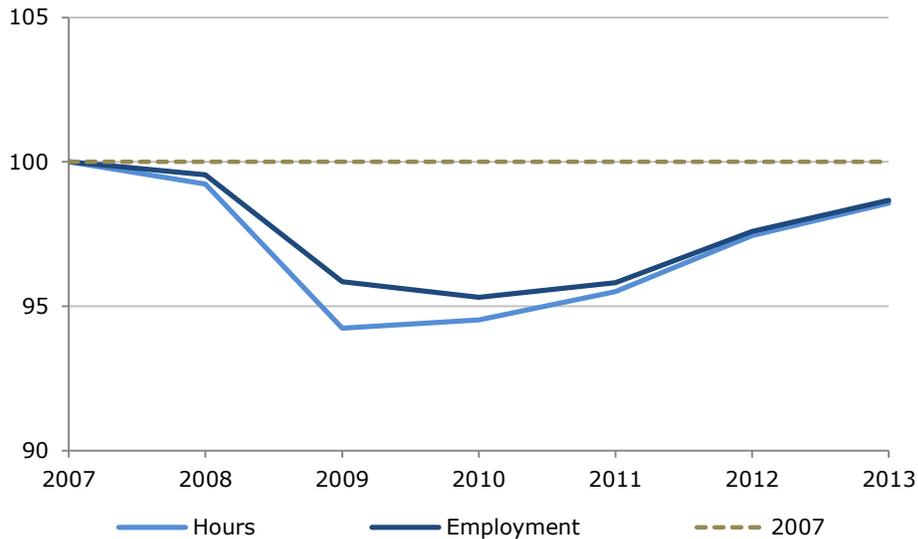
Turning our attention to the most recent developments, **Figure 9** presents OECD data on total employment and total hours worked in the United States in the years 2007 through 2013, all relative to total employment and total hours in 2007. (Note that the data here refer to the total number of jobs, not to employment as a share of the population.) Between 2007 and 2011, the total number of jobs in the US economy fell about 5 percent. Employment has recovered slowly since 2011, but it was still below its 2007 level six years later in 2013. (In 2014 --not shown in the chart-- the United States finally returned to its 2007 employment level.)

⁷ Blau and Kahn (2013) argue that a key reason why U.S. women's employment rates have fallen behind many of their OECD counterparts is because the United States offers much less support for women in work.

FIGURE 9

Change in Employment and Hours, United States, 2007-2013

2007=100



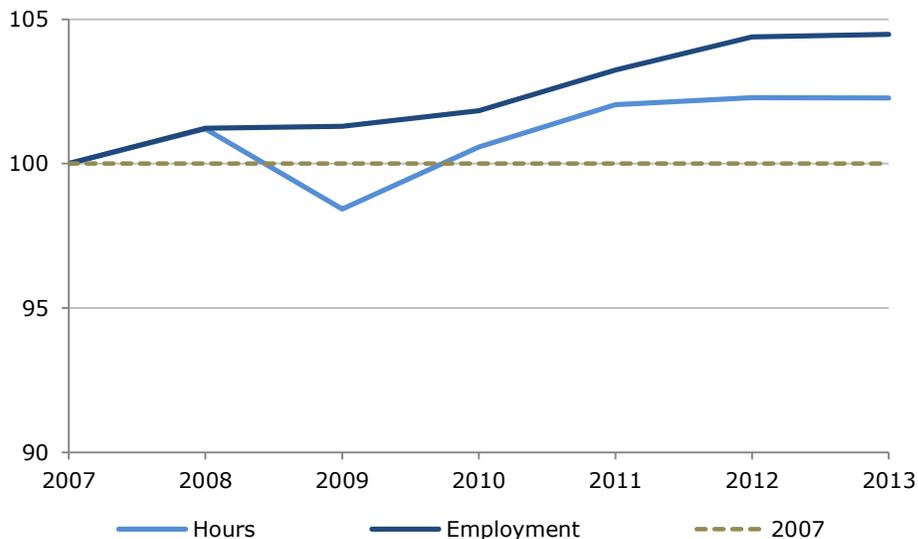
Source: OECD

This performance compares poorly to the experience of Germany (**Figure 10**), which has weathered the Great Recession far better than most of its rich counterparts, with both employment and hours up relative to 2007. But, even France (**Figure 11**), not generally held up as an economic success story, has outperformed the United States. Total employment and hours there held close to steady through the recession and the slow recovery.

FIGURE 10

Change in Employment and Hours, Germany, 2007-2013

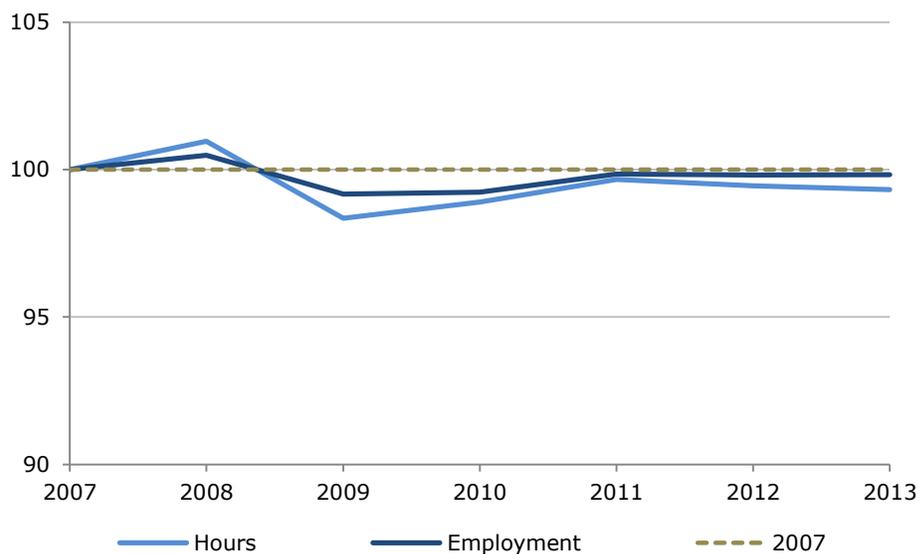
2007=100



Source: OECD

FIGURE 11**Change in Employment and Hours, France, 2007-2013**

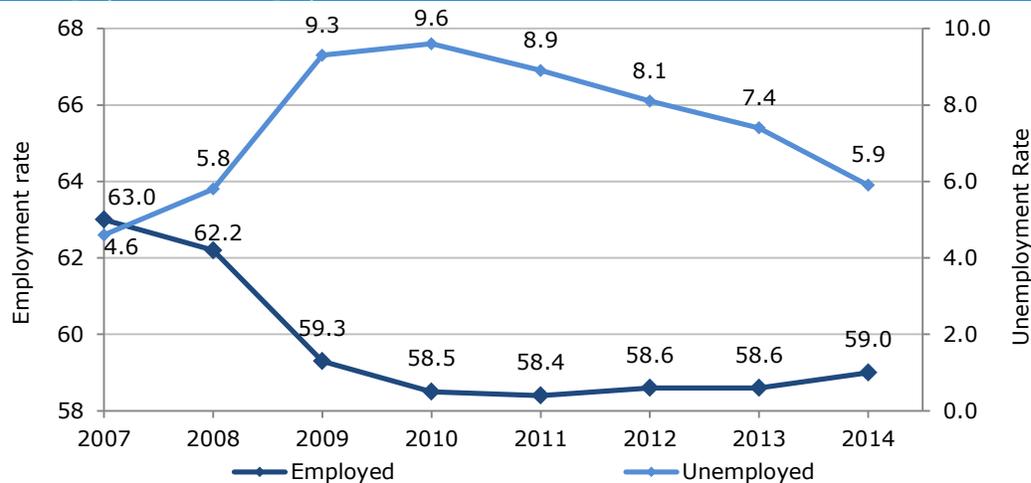
2007=100



Source: OECD

Another way to appreciate the depths of recent problems in the U.S. labor market is to look at the arithmetic of the decline in the unemployment rate. The top line in **Figure 12** traces the U.S. unemployment rate from 2007 to 2014. Unemployment rose from under five percent in 2007 to almost ten percent in 2010, but has been falling slowly ever since. The bottom line in the same chart shows the corresponding employment-to-population rate. Between 2007 and 2010, the employment rate fell about five percentage points, roughly mirroring the five percentage-point increase in the unemployment rate. Note, however, that the employment rate has barely changed since 2010 --up only about half a percentage point by 2013. The clear implication is that the decline in the unemployment rate over the current recovery is *not because the unemployed are finding work, but rather because the unemployed are giving up on the labor market*. This is a crucial point: labor-market flexibility is supposed to lower unemployment by creating jobs for the unemployed, not by encouraging the unemployed to stop searching for work.⁸

8 In the years since the official beginning of the economic recovery, the U.S. economy has month-to-month consistently created new jobs in the private sector. Private-sector job creation rates in the current recovery, however, remain well below what was achieved in the second half of the 1990s. As I argue below, job creation rates must also be measured relative to growth in the working-age population.

FIGURE 12**Unemployment and Employment Rates, United States, 2007-2014**

Source: Bureau of Labor Statistics

Deliberate Choices – Including Macroeconomic Policy

In the 1990s, the conventional wisdom in the economics profession saw inequality and unemployment as “two sides of the same coin.” Skill-biased technological change was a powerful force that would --in a flexible labor market-- express itself as higher inequality or, if labor-market institutions created rigidities that blocked this technology-driven rise in inequality, then those same economic forces would generate higher unemployment. Inequality and unemployment are indeed closely linked --not through “technology” and “market forces,” but rather, I would argue, through deliberate decisions about economic policy.

The connection between economic policy and economic inequality is straightforward and well-documented, so I will only provide a brief sketch here.⁹ But, I do want to emphasize an aspect of economic policy that has received too little attention as a contributor to both inequality and weak job growth: macroeconomic policy.¹⁰

The single most important reason for the rise in economic inequality since the end of the 1970s is the decline in the bargaining power of workers at the middle and the bottom of the wage distribution (Schmitt, 2009). This decline in bargaining power was itself the direct result of concrete changes in economic policy, including: the decline in the real value of the minimum wage; the

9 See, among others, Baker (2007), Bivens (2011), Galbraith (1998, 2012), Mishel et al (2012), Mishel, Schmitt, and Shierholz (2014), and Schmitt (2009).

10 On the importance of macroeconomic policy for inequality, see Baker and Bernstein (2014).

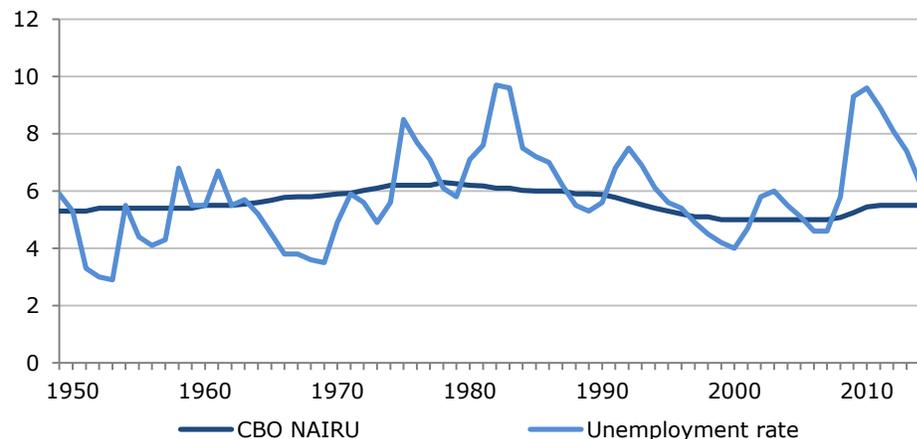
decline in unionization in the private sector;¹¹ the privatization of state-and-local government functions; the deregulation of industries including telecommunications, trucking, busing, airlines, and finance; the pursuit of a “corporate globalization” agenda focused on putting low- and middle-wage workers in the U.S. and elsewhere in competition with one another; a dysfunctional immigration system that puts U.S.-born low-wage workers with few rights in competition with foreign-born workers with even fewer rights; and macroeconomic policies that have not sought to maintain full employment. The common thread that runs through all of these policies is that they act to reduce the bargaining power of workers by changing the rules of labor and product markets. As Mishel, Schmitt, and Shierholz (2014) demonstrate, together these policy changes can provide a comprehensive account of the main features of wage inequality over time and across gender and education levels from the end of the 1970s through the present.

While economists have focused some attention on the role of institutions such as unions and the minimum wage in the increase in inequality, the profession has largely ignored the contribution made by macroeconomic policy.¹² One recent and important exception is Baker and Bernstein (2014), who make a strong case for the importance of macroeconomic policy failures in explaining both rising inequality and poor employment creation. **Figure 13** updates a key chart from Baker and Bernstein to include data through the first part of 2014. The chart shows the actual unemployment rate (light blue) and the Congressional Budget Office's (CBO) semi-official estimate of the Non-Accelerating-Inflation Rate of Unemployment or the NAIRU (dark blue), for each year starting in 1948.

FIGURE 13

Full Employment Cap, United States, 1949-2014

Percent



Source: Congressional Budget Office and Bureau of Labor Statistics

11 Schmitt and Mitukiewicz (2012) demonstrate a strong relationship between national policies and the change over time in union coverage and union membership in a sample of OECD countries.

12 On the minimum wage, see, Lee (1999) and Autor, Manning, and Smith (2010); on unions, see Card (2001) and, more recently, Western and Rosenfeld (2011).

Baker and Bernstein use the CBO's estimated NAIRU as an imperfect, but reasonable proxy for something close to the consensus level of what the unemployment rate would be if the economy were at “full employment.” By this reasoning, when actual unemployment is above the black “full employment” line, the unemployment rate is “too high” and we are forgoing national income by wasting resources. When the unemployment line is below the CBO's estimate of “full employment.” the unemployment rate is arguably “too low” and we run the risk of accelerating inflation. In this conventional framing, macroeconomic policy can safely reduce the unemployment rate to the estimated NAIRU without risks of accelerating inflation. What is striking about the chart, however, is just how much of the last four decades the United States has spent above the full-employment level of unemployment. (Note also from the same figure that this was not the case in the earlier postwar period --when, as we saw, incomes were growing rapidly and evenly across the distribution.)

Table 1 makes the same point in a sharper way. In the 36 years between 1979 and 2014, the US economy was at “full employment” (or better) in only 11 years --and the country fell short of full employment in 25 years. As the bottom panel of the table shows, if we use the distance between actual unemployment and the NAIRU (measured in percentage points of unemployment) to weight the years above and below full employment, the U.S. economy spent far more time with “too much” unemployment (38.8 “unemployment-years”) than it did with “too little” unemployment (5.4 “unemployment-years”).

TABLE 1
US Unemployment Rate Relative to CBO Estimated NAIRU,
1979-2014

| | |
|---------------------------|------|
| Years | |
| Total | 36 |
| At or below NAIRU | 11 |
| Above NAIRU | 25 |
| “Unemployment-rate years” | |
| At or below NAIRU | -5.4 |
| Above NAIRU | 38.8 |
| Net | 33.4 |

Note: Analysis of CBO, BLS data.

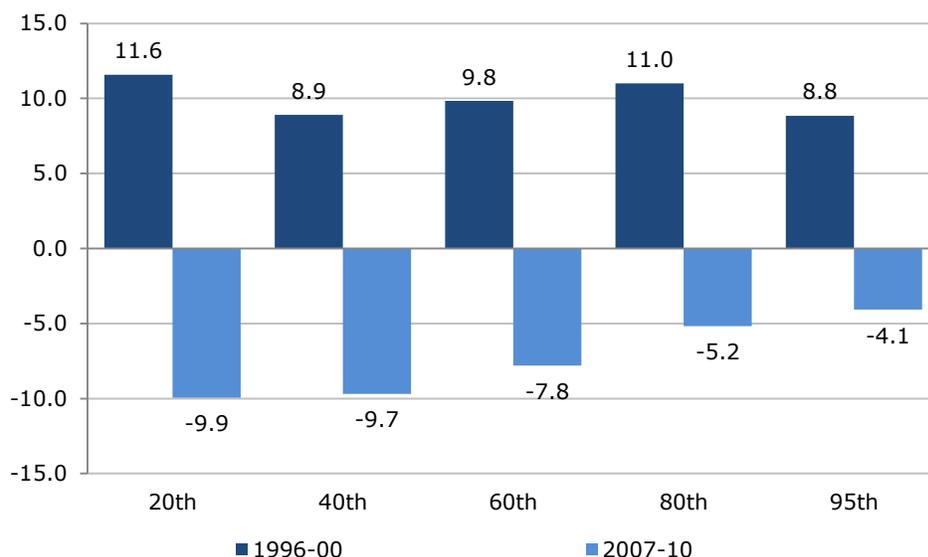
One reasonable interpretation of these data is that macroeconomic policy has consistently failed to reach what are arguably quite conservative estimates of the structural limits of the U.S. economy. This policy failure presents itself as a prime suspect in the breakdown of the U.S. jobs machine. Baker and Bernstein also link underpowered macroeconomic policy to economic inequality. As **Figure 14** shows, periods of sustained low unemployment, such as 1996-2000, are associated with high and roughly equal growth in family incomes across the entire distribution. Meanwhile, periods

of high and rising unemployment, such as occurred between 2007 and 2011, are associated with negative --and highly unequal-- changes in family income. Part of the reason for these outcomes is related to the simple fact that when unemployment is low, workers are more likely to work and more likely to work more hours through the course of the year. But, as Baker and Bernstein also emphasize, when unemployment rates are low, workers also have greater bargaining power relative to employers, who face increasing difficulties recruiting and retaining workers at the real wage levels they offered before labor markets tightened.¹³

FIGURE 14

Change in Real Family Income, by Percentile

Percent



Source: CEPR analysis of Census data.

Conclusion

Both the high degree of flexibility in the United States and the breakdown of the U.S. jobs machine after 2001 make a compelling case that U.S. employment problems are overwhelmingly *macroeconomic* in nature. While much of the academic and policy focus in the United States and especially in Europe is on the alleged need for more and deeper labor-market reforms, the recent experience of the United States suggests the importance of shifting the emphasis toward a reform of macroeconomic policy instead.

¹³ See also Blanchflower and Oswald (1994, 2005) and the related literature on the “wage curve.”

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