Research on the Disconnect Between Low Unemployment and Wage Growth in the U.S. and Coping Strategy

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Abstract. There has long been significant work available in the U.S. Indeed, unemployment rates have remained extremely low in recent years, but wages still have not. This has been a puzzle to most economists, who in the past have always expected that high employment should increase wages as organizations scramble for human resources. However, due to factors such as labor market density, inflation, technology, and the growth of gig economy jobs, the U.S. labor market has distorted this structure. This paper analyzes the trends in unemployment and wages, taking issues such as regional differences, low-skilled job polarization, and the effect of automation on the workforce into consideration. It also provides recommendations on how to deal with challenges, such as policies to support labor market flexibility, the creation of high-skill employment, and the ability to overcome inflation. The paper includes a synthesis of wage stagnation and realistic strategies to enhance wages in various sectors of the market economy.

Keywords: Wage Stagnation, Unemployment, Inflation, Labor Market, Automation.

1. Introduction

1.1. Research Background

The unemployment rate has long acted as one of the most important macroeconomic variables that give insights into the labor market state. According to classical economics, as unemployment is reduced, labor has a higher factor ratio, and thus, employment costs rise due to the scarcity of labor. However, this relationship has been recently challenged and questioned, especially in the United States, where even with a record-low unemployment rate, wages are still not rising. Usually, low unemployment suggested big boosts in wages, and this happened after the Second World War since there was a need for technicians and other experts. However, this relation has weakened in today's labor market, as covered by Autor & Dorn [1].

Several ways explain this gap, and one of them is the structural change in the U.S. labor market. The increase in the number of low-skill service jobs, as well as the polarization of employment, has changed the pattern of wage increases. Autor and Dorn, in their paper, opine that despite the creation of high-skill and low-skill employment, middle-skill employment, which was considered the key demand driver for wages, has dampened [1]. This has worsened and made it to the current trends on how the demand for low-skill service jobs does not lead to a rise in wages as would be in the skilled sectors. Also, Abdih & Danninger emphasized that progression in technology has undermined mid-skill occupations through automation, hence deepening wage stagnation [2].

Moreover, inflation rates have been used to slow down the growth of real wages. Relatedly, Donayre & Panovska noted that even though there are increases in nominal wages, inflation minimizes such advantages [3]. This was especially true in the period between 2013 and 2015, when inflation rates were relatively low while the corresponding wages were not rising as would be expected, indicating that inflation has a strong influence on wages. This relationship, commonly known as the wage Phillips curve, depicts a decline in the relationship between unemployment and wage level that exists because of inflationary pressures.

1.2. Literature Review

Various studies have been conducted to identify the correlation between the low unemployment rate and wage inflation. According to the works of Autor and Dorn, the decline of middle-wage jobs due to the creation of low-skill service employment has distorted wage structures [1]. In their space equilibrium model, they established that the local labor market, particularly those that undertake routine tasks, has been shifting low-skill laborers to service employment without any corollary real wage improvement. It has gone a long way in contributing to a wage freeze in those regions caused by low growth and development.

Donayre and Panovska analyzed the nonlinear relationship of the U.S. wage Phillips curve, and the findings showed that wage inflation has an inverse relationship with unemployment, but it depends on the phase of the business cycle [4]. Weakness: High inflation and above-average wage growth are seen during the phase of economic expansion, while low inflation and wage growth remain low, even with below-average unemployment rates observed in the recession phase. This model can be used to explain why either higher or sustained wages have remained almost nonexistent in situations where the agency of labor market performance is at its peak.

According to Leduc, Marti, and Wilson, their opinion is that claiming that ultra-low unemployment increases the rate of wage growth is invalid [5]. Their study using state-level data does not present evidence for a nonlinear relationship between unemployment and wage growth and thus strengthens the belief that other factors like inflation and the state of the labor market surely influence wages. This evidence corresponds with the view of Abdih and Danninger, where it is posited that the Phillips wage curve has become flatter in recent years, hence a weaker relationship between unemployment and wages [2, 5].

1.3. Research Gap

Substantial research was performed on separate factors, e.g., inflation, technological change, or job polarization, while the interconnection between these was analyzed only to a limited extent in terms of wage stagnation and periods of low unemployment. Previous studies have focused on two major areas: the ability of inflation to lead to a reduction in wage gains and the effects of automation on employment loss, but the layered effects of both factors remain understudied. The missing link is the understanding of how regional disparities combined with saturation in the labor market and a movement towards the gig economy contribute to compound wage suppression within low-skill segments.

1.4. Research Framework

This paper seeks to meet this need by sampling the multi-cause determinants of wage rigidity in the U.S. job market. First of all, it is concerned with the main interactions of unemployment and wage growth with an inflation factor and emphasizes technological changes. Second, this work examines changes in the organization of work, particularly the gig economy, and the effects they have on wages. Last but not least, the paper outlines measures to overcome these challenges, including the provision of skills-based employment opportunities and improving the mobility of labor. Thus, this paper aims to give an overall account of the reasons for wage stagnation through the exploration of relations between several economic factors.

2. Case Description

The trends in U.S. labor demand have shifted in the last three decades away from the middle-skill jobs but at a faster pace towards the low-skill service sector jobs. Such transformation, which Autor and Dorn detail, shows how employment has become polarized [1]. However, in the regions where most of the jobs are characterized by low-skill and low-tech, wage stoppage has been intensified. Employment has expanded in the recent past in service-based industries like retail, hospitality, and other related sectors, but this employment has not come hand in hand with the employment of high wages for employees. The lack of barriers in these industries also implies that there are numerous workers available for employment, thus minimizing wage rises.

At the same time, regional differences have only deepened the split between employment indicators and wage increases. Some technological hubs, such as Silicon Valley, have been known to have recorded high wage rates mainly because of the scarcity of workers. Nevertheless, according to Autor and Dorn's article, regions that rely heavily on factory or weak call center jobs have experienced little wage increase [1]. The above regional inequalities are a result of the differing rates of regional economic development all over the U.S., where some parts are highly developed as opposed to others; this is the reason why the wages remain stagnant in the country, even with low unemployment levels.

Unemployment has also remained a contentious issue, especially due to the emergence of the gig economy in determining people's wages. Most employees have been reduced to part-time or contract basis in companies such as Uber, Lyft, and other freelance services. These jobs, as can be seen, do offer employment, though most do not offer steady wages like full-time jobs, nor do they offer full benefits where required. Leduc et al. position this transformation due to the flexibility and growth of gig-based employment as causing wage stagnation due to these contracts being paid less than traditional ones [5].

The interrelated outcome of these factors has been the manufacturing of a labor force where low unemployment does not result in an increase in wages. This process is especially observed in those sectors where occupationally insecure employment with minimal skills and high competition are characteristic features, although wages do not grow.

3. Analysis of the Problem

3.1. Relationship Identified Between Unemployment and Wage Growth

The relationship between unemployment and wage growth is most often explained with the help of the wage Phillips curve, stating that when unemployment falls, wage increases should occur because of increased labor demand. However, in the recent past, the U.S. has suffered or rather witnessed a breakdown of this relationship.

3.1.1 Job polarization and wage stagnation

One of the main reasons why these two criteria differ from one another is job polarization. What is job polarization? Autor and Dorn explain that over a few decades, the U.S. labor market has been shifting towards the two extremes with the increase in both high- and low-skill jobs and the reduction in middle-skill jobs [1]. This means that there has been a shift from middle-skill jobs, and this has culminated in an increased concentration of employees in low-skill service industries that do not offer much growth in wages. Walmart and other such companies are typical examples of low-skill work, where the work tasks are easily distinguishable and yet cannot be mechanized while at the same time not requiring extensive training. Therefore, it puts employers under less pressure to raise wages as they have a reserve of cheap labor, especially in the relevant sectors. Hence, there is wage stagnation in addition to low unemployment levels, mainly because of the dominance of low-skill employment opportunities.

Further, Lee, Shim, and Yang affirmed that an increase in dual-earner households has resulted in this transformation toward the employment of low-skill service jobs [6]. This, in turn, has created a demand for substitutes for home production, like child and washing services, as most families, especially in urban areas, depend on two incomes. However, these are often low-wage jobs, and their wages have not risen due to the increasing demand for such services.

3.1.2 Inflation's impact on wage growth

Real wages are primarily influenced by inflation, but the relationship between inflation and wage effects has gained significance in the recent period. Hence, Donayre and Panovska posited that weakness in wage growth is normally observed during times of low inflation, irrespective of tight labor market conditions [3]. When researching the rate of increase in wages in the U.S.A. from 1965 to 2015, they concluded that although nominal wages increase, the purchasing power of wages tends to decrease due to inflation. Of course, this phenomenon is most clearly visible at a time when inflation is declining, for example, between 2013 and 2015, when the growth of wages did not accelerate despite the improvement of the situation in the labor market.

Jordà and Nechio have also pointed out that the sources of inflation after the COVID-19 period also affected wage fluctuations [7]. Federal stimulus measures prevented the further decline of wages during the pandemic, but rising inflation cut the value of wages, especially for low-to-mid earners. This dynamic emphasizes the breakdown of the relationship between employment levels and wages to grow more, and even a constant rise in inflation erodes any nominal wage increase.

3.2. Problems Identified in Wage Growth Analysis

3.2.1 Automation and technological change

Technology and automation have assumed strategic importance in the changing structure of the labor market in the U.S.A. Correspondingly, with the increase of companies that use automated technologies, the need for employees in repetitive mechanical occupations decreases. Autor and Dorn opined that middle-skill positions are easily replaced by automation, taking into consideration manufacturing and clerical occupations as examples [1]. This has resulted in more employees being locked in low-skill service occupations with less pay and a reduced rate of pay increase.

New technologies have resulted in new employment opportunities within highly skilled employment fields like data analysis, machine learning, and information technology. Nevertheless, these are skilled jobs. Leduc et al. found that workers lacking the right educational background end up struggling to slip into these employment opportunities [5]. Therefore, the increased demand for highly skilled workers and consequent supply have led to a high number of workers, with wages rising much faster than the average; conversely, there are those workers whose wages have remained stagnant or even declined.

3.2.2 Regional economic disparities

Economic development of certain regions also plays a major role in the stagnation of wages for the employees. Another key factor is the regional inequity. In areas like Silicon Valley, their respective wages have risen, mainly due to a high demand for skilled employment. However, according to the study by Autor and Dorn, in most parts of the geographical space of the U.S., particularly in the rural areas or areas that relied on industries that are now in the process of decline, wages have hardly grown [1]. All these spatial differentials depict the economic geography of recovery from the great recession, whereby some locales continue to experience economic struggles while others are surging forward.

The continuation of these spatial inequalities suggests that national trends for unemployment and wages may obscure a great deal of disparity across the country. This is because, in such regions where most of the employment opportunities are in the low-tech service sectors, wages have not registered any steady increase, notwithstanding the declining unemployment rates. Abdih and Danninger, below, discuss why regional disparities have emerged as an important factor to consider as to why wages have not started growing across the country despite the improvement in labor market conditions [2].

3.2.3 Decline of labor unions and bargaining power

Lee et al. proposed that the decline in the power of labor unions in the last couple of decades has also contributed to low wages. Earlier, unions offered the needed weapon in a worker's hand through bargaining to demand higher wages as well as better working conditions. However, over the years, union density has reduced, especially in sectors that employ low-skilled workers, and this means that workers cannot push for a wage increase [6].

However, an extension of employment flexibility made job seekers vulnerable and weakened their bargaining power, notably with the advance of the gig economy. Freelancers, also known as gig workers, remain vulnerable since they cannot be offered protection by labor laws and cannot join unions. Therefore, they experience unpredictability and a relatively slow increase in wages as compared to other conventional fixed-term employees. Contract and part-time work have, therefore, fueled the general tendency of wage decline in the U.S. labor market, as revealed by Leduc, Marti, and Wilson in their work [5].

4. Suggestions

To seriously begin to attack stagnated wages in the U.S. labor market, more straightforward and comprehensive approaches have to be employed that would look to address all of the factors highlighted in the discussion. The suggestions listed below provide strategies to address some of the causes of wage stagnation through improving jobs, minimizing geographical inequality, and improving employees' rights.

4.1. Invest in Education and High-Skill Job Training

A great solution to wage stagnation is through education and vocational training for workers to produce quality that can be suited for higher wages. As the levels of job automation and technological development rise, the demand for people with unique expertise in improved, higher-level skills such as I.T., machine learning, and manufacturing skills is rising.

Abdih and Danninger stated that retraining and equipping workers with skills relevant to the modern labor market can aid in reducing wage dissimilarities between low-skilled and highly-skilled employees [2]. Thus, if the decision-makers provide workers with a chance to obtain tertiary degrees and vocational training, they can contribute to getting workers away from low-wage and service occupations. Orlando et al. proposed that these monies would not only increase workers' wages but also foster better social mobility throughout the economy [8]. Furthermore, programs that are aimed at low-income neighborhoods or areas with high concentrations of low-skill work could, therefore, facilitate the elimination of the geographic wage differential.

4.2. Address Regional Economic Imbalances

The slow growth in wages for workers is another concern that requires policymakers' attention, especially those in different regions. Employment sectors that are enriched by technology, such as Silicon Valley, have experienced a greater rise in wages than other regions, especially those that overdepend on low-skilled jobs. For these imbalances to be fixed, specific economic development initiatives must be extended that aim to promote development in areas that have poor or declining rates of economic growth.

Maybe it is time for the administration to direct its significant resources toward infrastructure, new technologies, and other innovation zones, including developing them in small towns and cities. Such a policy would ensure that different regions develop and ensure that the wages for workers in different areas of the country are brought to par. According to Autor and Dorn, policies to generate local industries and encourage the mobility of labor within these regions may lessen the skills differential in wages [1].

On the same note, Coibion et al. argued that policies encouraging businesses to invest in economically deprived zones to create employment could also offer wages a boost in the post-industrialization age geography [9]. Superior legislation should offer incentives to businesses willing to invest in these areas in the form of tax, grants, or subsidies for such development as a way of jumpstarting local economies besides enhancing wage trends.

4.3. Strengthen Labor Unions and Worker Bargaining Power

The reduced bargaining power of labor unions, plus the increase in gig workers' employment, has left low-skill employees with limited bargaining power when it comes to demands for higher wages. Enhancing unions and opening up bargaining rights might enable employees to call for enhanced wages and improved working conditions. Lee, Shim, and Yang stated that wage stagnation is partly because many employees are no longer able to join trade unions, which used to act as bargaining employers [6].

There should be improvements in legislation that will allow unionism for employees, especially in the region offering low-skill employment. More so, protecting the rights of gig and contract employees who are, in most cases, denied ideas like the protection of employees' unions can be a possible solution to wage inequalities in gig economy workplaces. For instance, Leduc et al. argued that applying the minimum wage legislation, healthcare coverage, and job-sustainability guarantees to gig workers will limit wage uncertainty and promote wage increases among these workforce agents [5].

4.4. Address Inflation's Impact on Real Wages

This can be attributed to the fact that inflation reduces the real value of wages; therefore, a solution to the effects of inflation is important to support wage growth. Governments should see to it that they arrange policies that help to reduce inflation within the economy without putting much pressure on wages. That policy could be to pursue more of the electronic or money-base that fosters a stable inflation rate but does not wet down employment generation. According to Donayre and Panovska, whilst controlling for inflation from wiping out any nominal wage hike, it is noteworthy that inflation is not necessarily detrimental to an economy [3].

Further, indexing wages to inflation could also guard workers against the impact of inflation via a rise in wages' cost. Ferri et al. presented that tying the wage rate to inflation would help ensure that no nation faces falling real wages when inflation rises [10]. This might be a bit hard to achieve throughout sectors, but it can be done in sectors that directly come in contact with high-inflation vulnerable groups, such as service employment at low wages.

5. Conclusion

5.1. Summary of Key Findings

Ultimately, this paper has sought to discuss the phenomenon of low unemployment rates coupled with wage stagnation in the U.S., which has been the main focus of discussion in this paper. The polarization of employment opportunities, especially due to an increase in low-skill service positions and a decrease in middle-skill technical ones, has been a problem. Low-skilled workers earn less because supply exceeds demand, while high-skilled workers enjoy larger wage increments since their demand is relatively high. Further, inflation has also been the main player in stopping real wage growth because the prices counter any nominal wages.

Considering regional wage disparity, wage increases are observed to be concentrated in regions with technological advancement, while wages stagnate in regions that are economically challenged. Additionally, the shifting of the economy towards the 'gig economy' and the dwindling membership of the labor unions has reduced the bargaining power of the workers and has provided yet another reason for wage stagnation.

5.2. Research Significance

The conclusions of this paper are as follows, and they present the structural problems of low wages in the U.S. labor market. Solving these problems is of paramount importance in increasing the rate of upward economic mobility, boosting wages, and decreasing income polarization. This means that by aiming at the education aspect, regional development, labor issues, and inflation containment, then policymakers would be well inclined to increase the wages that accompany the low unemployment levels. All these are important not only in enhancing the health of the workers but in the stability and development of the U.S. economy as well.

5.3. Limitations and Future Research

This study has only used secondary data, and thus, it is unable to capture current changes in the labor market. There is scope for future research by collecting more primary data through surveys and interviews, especially to understand the effect of new phenomena like remote working and technological changes on wage increases. Furthermore, more extensive research concentrating on certain areas or sectors would offer a better understanding of the real impact of wage stagnation, along with the reasons behind it and the types of policy remedies to apply.

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