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Low Wage Jobs and Pathways to Better Outcomes

Summary

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Summary

i. The Task

This monograph examines the extent to which low wage jobs provide access to and progression in employment for low skill workers. More specifically, it examines:

- The extent to which low pay jobs provide the first step on the ladder to reasonably paid and reasonably secure jobs for low skill workers;
- Conversely, the extent to which low skill workers become stuck in low paid and insecure work;
- What are the characteristics of people who are employed in low wage jobs;
- Which types of low paid jobs provide the best/worst chances of upward mobility;
- Whether a low paid, insecure job is better than no job;
- Whether low skill/low pay jobs can coexist with high skill/high pay jobs for similar work;
- Whether the supply of low skilled/high skilled workers affects the demand for low skilled/high skilled workers;
- Whether different causes of low skill (low education, poor schooling or parenting, history on welfare, crime, drug dependence etc) affect future labour market outcomes.

The answers to these questions are derived from a review of the literature. Most attention is paid to the economics literature as it applies to the US, the UK and the OECD more broadly. We draw also on some relevant psychology literature.

Low wage jobs play an important role in the pathway to work for low education youth. They are important also for women re-entering paid employment after an absence to care for children, and higher wage workers who lose their jobs.

The key question of interest is whether people in low wage jobs stay there for a long period, or simply transit them on their way to better paid work. In the first case, low pay can cause continuing poverty and lifetime (indeed, intergenerational) inequality. In the second case, any poverty will be short term and scarcely impact on lifetime well-being.

The English-speaking countries have seen a substantial growth in inequality of wages and in the proportion of jobs that are some combination of low paid, casual and part-time. If there is little mobility out of such jobs, then there is a real risk that their relative growth will generate an underclass of people and families who have to deal for long periods, possibly a lifetime, with poverty and insecurity.

The main empirical task is to identify the extent of wage mobility. A second important task is to understand the scope for policy to improve the outcomes for low wage workers.

ii. Some Background

ii.i Growth in Inequality

The twenty or so years from the mid 1970s to the mid 1990s was not a good time for lower skill workers, especially those in the main English-speaking countries. Developments in the United States highlight trends that were apparent in more muted form elsewhere (including in Australia). In brief, in the US

- Wage inequality rose substantially for both men and women full-time employees, with particularly fast growth in wages occurring at the very top;
- Real wages for men *fell*, with the lowest wage earners losing the most (up to 30 per cent of the value of the real wage);
- Increased cross-section wage inequality has not been offset by a rise in wage mobility over time or a compression in non-wage benefits, so that longer term inequalities have also risen.

ii.ii What are Low Wages?

There are a variety of ways in which to approach the definition of low wages. Most empirical work adopts a threshold value that is some fraction of a measure of central value for wages (the median or the mean). Two thirds of the median is commonly used. Another approach sets an absolute value that is derived from the circumstances of the particular economy, such as the official minimum wage or a small quantity above it.

The important thing to note about the choice of definition is that the extent of mobility and the number and characteristics of low wage workers will be affected by the choice that is made. For example, the lower the level chosen, the more will low wage workers be young, female and have relatively high mobility into higher paying jobs.

iii. Who are the Low Wage Workers?

While the incidence of low wage work varies considerably across the OECD, the types of people in low wage jobs and the work they do are quite similar. In brief, low wage jobs are disproportionately found among those with relatively little education, among women and among youth and older workers.

In migrant countries, recent migrants who do not speak fluently the language of their new country are also prominent among low wage workers.

Table 1 shows the proportion of people with particular attributes who are low paid, in a range of countries.

Table 1: Incidence of Low-Paid Employment by Sex, Age and Education (per cent)

	<i>Aust.</i>	<i>Canada</i>	<i>Germany</i>	<i>N.Z.</i>	<i>U.K.</i>	<i>U.S.A.</i>
Total	13.8	23.7	13.3	16.9	19.6	25.0
<i>By sex:</i>						
Men	11.8	16.1	7.6	14.4	12.8	19.6
Women	17.7	34.3	25.4	20.7	31.2	32.5
<i>By age</i>						
Under 25 yrs	34.5	57.1	50.4	41.3	45.8	63.0
25-54 yrs	8.8	20.1	6.7	11.6	15.0	21.2
55+ yrs	12.5	20.8	5.4	15.6	22.9	23.7
<i>By education</i>						
Basic	n.a.	36.3	15.9	23.5	n.a.	54.5
Upper sec.	n.a.	28.5	26.3	10.7	n.a.	32.4
Higher	n.a.	17.6	4.2	14.2	n.a.	15.5

Note: * The data refer only to full-time workers. Low wage is defined as less than two-thirds of the median earnings for full-time workers.

These low wage workers are found concentrated in a few industries and occupations. The biggest employers of low wage workers are retail, wholesale, hospitality, personal and business services. Low wage workers are employed in sales, in catering, as clerks, childcare and eldercare workers, labourers and farm workers. They are likely to be employed by small private sector firms.

iv. Why Employ Low Wage Workers?

The main reasons why firms employ low wage workers are:

- The job is intrinsically low skill, given current technology.
- Firms choose a production technology that is low skill labour intensive, where higher skill labour or capital could have been chosen instead.
- Firms prefer to operate a low skill/low wage/low training strategy and recruit what skills they need directly from the market.

There is evidence that firms that produce essentially the same product make different choices about the level of skills, wages and training that they adopt.

v. Why Accept Low Wages?

For the most part, people accept low wages because they cannot do any better—including finding non-wage sources of income such as a partner or social welfare. Frequently this means that they have low levels of employable skills or their skills are in low demand. For many, this means that they have low levels of formal education and/or of training on the job.

Low wages may be the result of a poor job match between the skills of the worker and the requirements of the employer.

They may also result from (and in cases clearly do) discrimination on the basis of sex and race.

Some people will accept a low wage because the job has other attributes that appeal. These may be geographical convenience or flexibility about timing; or particularly attractive work such as in the arts or the environment; or extensive training that improves the prospects of higher wages in future.

vi. How Much Mobility is There?

There is a high degree of wage mobility for young people paid near the minimum wage. Sixty per cent of young US minimum wage workers had a real wage increase in their first year of employment.

In contrast, if a modestly higher threshold wage is used, and workers of all age groups are considered, the rate of movement to a higher real wage is much reduced. Mobility is much lower still if movement out of the labour force or into unemployment is considered.

The full monograph shows levels of wage mobility over a five year period, for people who were employed in a low wage job at the beginning of the period.

Between 26 per cent (Denmark) and 40 per cent (Germany) of low wage workers were not in full-time employment five years later. For the US, fully 70 per cent of people employed full-time on low wages in 1986 were either not in full-time employment or were still in low wage jobs five years later. Upward mobility was a minority experience in the US and Germany, in clear contrast to Denmark and Sweden.

Sole mothers are a substantial component of the low wage labour force and we look in some detail at their experience. For the majority of sole mothers, low-wage work provides the only entry point into paid employment, because (at least in the US, where most of this research has been conducted) most mothers lack the education necessary for higher-wage jobs. Thus, low-wage work plays a major role in the labour force participation of sole mothers. But these low-wage jobs do not provide a pathway into higher-wage jobs. Instead, sole mothers appear to become stuck in low-wage jobs indefinitely, because these jobs do not provide opportunities for skill development. As a result of this lack of opportunity for on-the-job learning, and because low wage jobs involve considerable insecurity and make caring for their children difficult, many sole mothers give up and return to government benefits, if they are able to.

vii. Sources of Mobility

The main sources of upward mobility are finding a better job match, obtaining wage growth on the job as a result of accumulating skills, and undertaking formal education courses off the job.

The literature does not provide a nice comparison of the importance of each of these. But it is clear that most low wage jobs do not provide much opportunity for wage growth on the job. This can be interpreted to mean that workers are not obtaining much on-the-job training in these jobs. Firms are more likely to invest in the skills development of higher educated, higher paid workers. There is strong empirical evidence that low wage workers have higher rates of turnover

than higher paid workers. This inhibits both firms and workers from investing in the development of job-specific skills. What is not clear is whether the low wages cause the high turnover, or vice-versa.

Low wage jobs mostly provide relatively little training and are offered by low productivity firms. The greatest chance of upward mobility for a relatively low skill worker is to get a job with a high productivity firm that is paying relatively high wages (hence faces relatively low quit rates). As a result of the low quit rates, this firm will be prepared to pay for skills development of its workers, and hence provide the conditions for upward wage mobility.

National variation in culture and institutions affects the nature and amount of on the job learning that occurs, especially for new entrants. Compared to Germany and Japan, the US has a higher flow rate both into and out of unemployment, and relatively efficient job matching processes. This helps to explain why firm-provided training in the US is relatively low: it is more efficient for firms to recruit the skills they need than to develop them among their existing workers. Freeman (1995), after a careful comparison of Germany, Japan and the US, concludes that 'considerable institutional structure is needed to induce firms to provide training to workers.'

viii. Is a low wage job better than no job?

The surprising answer to the question of whether a low wage job is always better than no job (unemployment) is no. It does depend on what is meant by 'better'. Many studies have found that a low wage job is more likely to lead to employment in the next period than is being unemployed. But it is difficult to establish what is the true cause of this relationship. A recent careful study seeks to establish the independent effect on future status of either being unemployed or being in a low wage job. It concludes that that the impact of being unemployed in period 1 on the probability of being unemployed in period 2 is not statistically different from the impact of being in a low wage job. In coming to this conclusion, the author excludes from the analysis people who were continuously unemployed over the whole period. A second conclusion is that being in a low pay job in period 1 has a similar impact as being unemployed on the probability of being in a low pay job in period 2. Low paid work and unemployment have almost an equally large (negative) impact on the probability of moving to a higher paid job, compared to higher paid employment.

In support of this rather surprising finding are conclusions from the psychological literature about the consequences for mental well-being of unemployment compared with employment in a poor job. In brief, studies consistently suggest that 'bad' or unsatisfactory employment is no better for a person's psychological well-being than having no job at all. A series of studies followed school leavers as they entered the workforce. They concluded that those who ended up with jobs that they regarded as unsatisfactory, were no better off psychologically than the unemployed. Whereas there were no differences between the unsatisfactorily employed and the unemployed on levels of self-esteem, locus of control, depression, negative mood, psychiatric symptoms, psychological distress, hopelessness and social alienation, the satisfactorily employed (and full-time tertiary students) displayed superior well-being on all of these psychological measures.

The Monograph concludes with a discussion of possible policy responses that could limit the negative social and economic consequences of low wage jobs.