News and Views from the Dismal Science

Dr. Econ's commentary on global economic and other affairs

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Labor income

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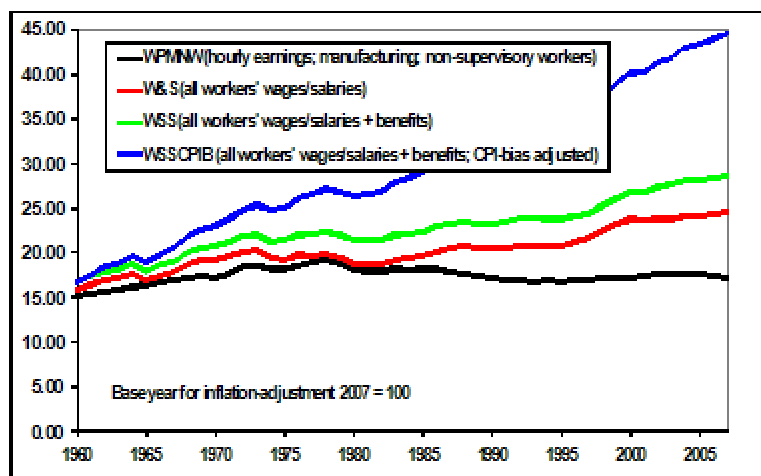

In October 2005, I wrote a column on labor earnings in the United States, with data through 2004. By now, data for almost 3 more years are in, through the third quarter of 2007. With the economy tumbling into a recession, average earnings won't get any better during the remaining months of the current administration. So, let's have an updated look at the numbers. (For comparability, all numbers are adjusted for the general decline in average hours worked as well as for general consumer price inflation, with 2007 as the year of comparison.)

In the Figure, the bottom line, drawn in black, represents inflation-adjusted hourly earnings of non-supervisory manufacturing workers. Since 1960, their income has increased by 14.4%, from $15.06 to $17.23. Over 48 years, this averages to 0.3% per year. Nothing much to write home about. However, manufacturing employment, at barely over 10% of all employment today, as opposed to 28% in 1960, is really not the place to look for the average American worker anymore.

More relevant is the red line. This captures all private and government workers' wages and salaries, converted to an hourly equivalent. The increase over 48 years is 55%, or about 1.1% per year. Still not much. Now include the hourly value of employer contributions to pension and health funds (but not employers' social security contributions, which are taxes). That yields the green line, with an increase of 70.7% or not quite 1.5% per year. Finally, we need to adjust for a known overstatement in the way government computes consumer price inflation, yielding the blue line. Now the increase in average total compensation is a much more realistic 3.5% per year. However, productivity per hour worked of the American worker across all business sectors has grown by 3.8%, somewhat more than the inflation-bias adjusted wages and salaries. But when farming is excluded —

a small but extraordinarily productive sector — workers' pay rise on the whole is in line with their increased productivity.

This is as it should be and tells us that the inflation-bias adjustment works pretty well. So far, so good, therefore. But there is at least one oddity in the data. Since 2001, productivity increased by 15.5%, whereas the average worker received only 10.6% more wages, salaries, and benefits in inflation-bias adjusted terms. And much of that was eaten up by the higher dollar-value of employer-paid pension and insurance schemes, rather than by take-home pay. This can be seen in the Figure, in that the red line (without benefits) is essentially flat since 2001, whereas the green line (with benefits) has been increasing. Thus, the even steeper rise of the blue line is due mainly to the increase in the benefit values, rather than to increases in take-home pay.

Take-home pay, however, is what workers live on. We have seen such stagnation before, for example during the second Reagan and first Clinton terms. But combine the current situation with the stock market gyrations of the early 2000s, the mortgage crisis now, and three-dollar a gallon gas and higher food prices to boot, and it is easy to appreciate that the United States has had somewhat of a rocky start into the twenty-first century. This is why the economy, rather than the various U.S. wars, is likely to dominate the presidential elections.

To me, and probably to most economists, the thing to listen for is what the presidential aspirants wish to have achieved by the time they are long out of office, that is, feasible plans that put the economy on a long-term path to sustained (and sustainable) economic growth. This includes things like health, education, and personal safety over which, in constitutional terms, the President actually has little say. More likely, the candidates will therefore debate short-term schemes, over which the President does have some influence, stabilization policy rather than growth policy. But even the one area over which the President does have decisive influence — foreign and security policy — can be usefully discussed if it is coached in terms of economics. The three trillion wars, roughly equivalent to the upcoming fiscal year's entire U.S. federal government budget, are rather a mite expensive, with much of the bill due in future years for things such as long-term disability payments for permanently injured servicemen and women. And that's for fighting in Afghanistan and Iraq, not exactly military powerhouses.

Surely, there are better ways to expend taxpayers money. So, listen with care, and vote well.

Note: All computations are based on the *Economic Report of the President 2008* (released February 2008).

Jurgen Brauer's latest book, co-authored with Hubert van Tuyll is *Castles, Battles & Bombs: How Economics Explains Military History* (Chicago, IL: The University of Chicago Press, 2008).

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