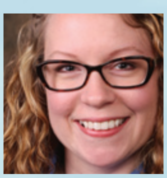
The Why of Weak Wages

Technological advances. Lower productivity. Fewer full-time workers. Depending on whom one asks, the reasons vary for why we've experienced more than a decade of low wage growth. Observers agree, though: Stubbornly low wages impact society and the US economy.



Michelle Park Lazette
Staff Writer

Both of the economists, independent of each other, call the trend puzzling.

Why, if the unemployment rate has fallen from 9.5 percent at the recession's end a half decade ago to 5.5 percent as of May this year, does wage growth remain low and slow?

"It's a bit puzzling how wage growth has been so depressed," Federal Reserve Bank of Cleveland Senior Research Economist Filippo Occhino says. "We are in the later stages of the recovery, and typically in past recoveries, wage growth had picked up much, much earlier.

"At the beginning of any recovery, wage growth is low," Occhino adds. "With so many unemployed people, businesses don't need to raise wages. Then, as a recovery progresses and the labor market tightens, you should expect more competition and a bit of higher wage growth. But, we don't see that. We see low wage growth."

Occhino

Elvery

Wage growth had been marginal even before this most recent recession, notes Cleveland Fed economist Joel Elvery.

"There was remarkably little wage growth between the 2001 recession and the beginning of the 2007 recession," he says. "There was some income growth at the very high end of the income distribution, but there was actually very little at the middle or at the low end. So, overall wage growth was quite flat before the [2007] recession, as well."

Data from the Bureau of Labor Statistics tell the long, slow-wage-growth story, too: For 12 of the 22 major occupation groups tracked by the BLS, average annual wages adjusted for inflation shrank from 2004 to 2014. Two more of them registered no wage change during the decade, and only 2 experienced an increase of more than 5 percent in average annual wages.

Tempered by technology

Both Occhino and Elvery recently published research about the lack of American wage growth.

In a piece titled "Behind the Slow Pace of Wage Growth," Occhino and Cleveland Fed research analyst Timothy Stehulak identify 2 factors keeping wage growth low: low productivity growth and labor's declining share of income.

Average productivity growth—that is, growth of the output of employees, or the goods and services produced relative to the labor hours spent—was 3.5 percent between 1997 and 2004. After 2004, however, it has averaged 1.5 percent.

"When the productivity of workers rises, through competition, employers pay more for their workers," Occhino says. "So one reason why wage growth has been low is productivity growth is low."

Productivity is influenced by various factors, mainly a worker's skillset and education. Also driving productivity is the capital, such as equipment, afforded to each worker.

"One possibility is that the high productivity growth at the end of the century was sort of temporary or that the current productivity growth is depressed by something," Occhino says. "It could be that it is suppressed by the consequences of the Great Recession."

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Occhino's recent research also shows this: Labor income has declined as a share of total income earned in the United States. In other words, labor income, which includes wages, salaries, and other work-related compensation, has declined relative to capital income, which includes rent, interest, dividends, and capital gains.

Though both labor income and capital income have increased over time, capital income has increased at a faster rate.

Occhino cites a few reasons why labor's share of total income has declined.

"One could be simply technological change that has favored [investment in] capital to labor," he says.

Technological shifts have put strong headwinds on wage growth, Elvery notes.

Another reason could be globalization, which allows firms to import goods from other countries rather than producing them (and paying labor to produce them) in the United States, and there's also the loss of bargaining power by labor. Unionization, Occhino notes, has declined.

Holzer

Harry J. Holzer also cites the substitution of technology for workers and the use of imports and offshoring as reasons why employers seemingly haven't had to work as hard to attract and retain workers since 2000. Wages, he points out, haven't kept up with inflation even with inflation's being quite moderate.

Holzer, a professor of public policy at Georgetown University and a visiting fellow at The Brookings Institution, has focused his research during most of his career on the low-wage labor market.

"Our standards of living require higher wage growth, so it's very discouraging to workers," he says of the trend. "Especially if you think of college graduates, who were told, 'Go to school. There is a strong reward for schooling.'

"When wages are flat, it limits the amount of expansion in personal consumption, so it stifles the growth of the economy."

"The general finding is that the only place you see wage growth since 2000 is for people with graduate degrees," Holzer adds. "Even college graduates with bachelor's degrees have had flat or even slightly declining earnings, adjusted for inflation."

'Noticeable declines . . . everywhere'

Typically, average wages go up during a recession and fall during a recovery. This is largely because occupation mix changes during recessions, explains Elvery of the Cleveland Fed.

Because it is easier to find low-skilled workers, firms are more likely to fire low-skilled than high-skilled workers during a recession. This changes the occupation mix and pushes the average wage up. In addition, some industries—for example, manufacturing and construction—are more susceptible to cyclical conditions, so occupations prevalent in those industries also decline during recessions.

These cyclical changes in occupation mix usually reverse themselves during the recovery. However, recessions can change the mix of occupations in more permanent ways, too. Firms that cut staff during a downturn may alter what they do, and who they employ doing what, when the recovery occurs.

Elvery wanted to know how much of the recent change in average wages (or lack thereof) is due to changes in the occupation mix rather than wage change within occupations.

Using the Bureau of Labor Statistics' Occupational Employment Statistics, Elvery and Cleveland Fed research analyst Christopher Vecchio sought to determine whether wages are flat or falling by examining a fixed sample of occupations over time.

Elvery identifies 2 major takeaways. One, when he examined wages adjusted for inflation during much of the recovery from 2010 through 2013, "there were noticeable declines pretty much everywhere we looked."

"To me, it's a sign of how weak the labor market was in 2010 to 2013," Elvery says.

Controlling for occupation mix in Ohio, a state within the Cleveland Fed's region, average inflation-adjusted wages fell 3.5 percent between 2007 and 2013, Elvery found.

"That means that people who didn't change occupations experienced substantive real wage loss since the recession started," he says.

Ohio's numbers were worse than those of the nation, Pennsylvania, West Virginia, and Kentucky. US average wages—keeping occupation mix constant—fell 0.6 percent in the same timeframe, as did Kentucky's, while Pennsylvania's wages climbed 1.2 percent, and West Virginia's increased 0.8 percent. (Like the state of Ohio, parts of Pennsylvania, West Virginia, and Kentucky are served by the Cleveland Fed.)

The second major takeaway? The 2 Cleveland Fed researchers observed little change in real average hourly wages in Cleveland and Cincinnati between 2007 and 2010 and also between 2010 and 2013, the time periods referenced in the study.

"Where you see very little change in average wage either during the recession or during the recovery, that's surprising," Elvery says. "You would think that we would have had a large shift in average wage. It's puzzling that we had such little change."

But the way Elvery and Vecchio decomposed the change allowed them to see that declines in wages within occupations were essentially completely offset by shifts to higher wage occupations.

A problem for the economy

From Teresa Carroll's vantage point, the reason for slow wage growth in certain occupations is simple supply and demand.

Where there is high supply and low demand (think light-industrial and logistics-related occupations), slow wage growth persists, says Carroll, senior vice president and general manager of KellyOCG, a group of the workforce solutions company, Kelly Services, which does business in all of the Cleveland Fed's region and globally.

There's another reason for slow wage growth, according to Carroll: 35 to 50 percent of companies' talent is not full time.

Carroll

"Years ago, it was, 'Here's the job, here's the role, you work full time, you get these wages, and supply and demand is going to drive what happens with those wages,'" Carroll says. "There was the promise of loyalty both by the man and the company, and a lot of wage inflation happened as a result of that loyalty.

"Nowadays, up to 50 percent of the talent of a company is non-full-time," she continues. "It's giving companies an option to get the work done without increasing wages to their full-time workforces. If you have a project that you need completed in an IT department, rather than increasing wages of talent to do so, you could utilize independent contractors, you could work with an outsource provider, you could bring in a contractor."

Sources say it matters well beyond individual households when wages don't grow.

For one, wage growth affects inflation. The greater the wage growth, the greater the inflation.

Plus, wage growth may be related to inequality, the Cleveland Fed's Occhino says. People who receive a greater share of their income through labor, rather than through earnings such as interest and capital gains, tend to be poorer, Occhino says.

"Given that, obviously if the labor share of income declines, you're going to have a little bit more inequality," he says.

Young workers have been hit especially hard by the lack of wage growth, Holzer says, and a lot of workers have pulled out of the labor market. That move carries consequences.

"That's a problem for the United States economy," Holzer says. "If fewer people are willing to work, you're losing productive capacity."

Where the growth is

Of the 20 occupations projected by the Bureau of Labor Statistics to grow the most jobs between 2012 and 2022, 14 have a 2012 median annual pay of less than $35,000. The occupation expected to grow the most jobs—580,800—is personal care aide, whose 2012 median pay was $19,910 per year.

Occupation	Number of projected new jobs, 2012–2022	2012 median pay (annual)
Personal care aides	580,800	$19,910
Registered nurses	526,800	$65,470
Retail salespersons	434,700	$21,110
Home health aides	424,200	$20,820
Combined food preparation and serving workers, including fast food	421,900	$18,260
Nursing assistants	312,200	$24,420
Secretaries and administrative assistants, except legal, medical, and executive	307,800	$32,410
Customer service representatives	298,700	$30,580
Janitors and cleaners, except maids and housekeeping cleaners	280,000	$22,320
Construction laborers	259,800	$29,990
General and operations managers	244,100	$95,440
Laborers and freight, stock, and material movers, hand	241,900	$23,890
Carpenters	218,200	$39,940
Bookkeeping, accounting, and auditing clerks	204,600	$35,170
Heavy and tractor-trailer truck drivers	192,600	$38,200
Medical secretaries	189,200	$31,350
Office clerks, general	184,100	$27,470
Childcare workers	184,100	$19,510
Maids and housekeeping cleaners	183,400	$19,570
Licensed practical and licensed vocational nurses	182,900	$41,540

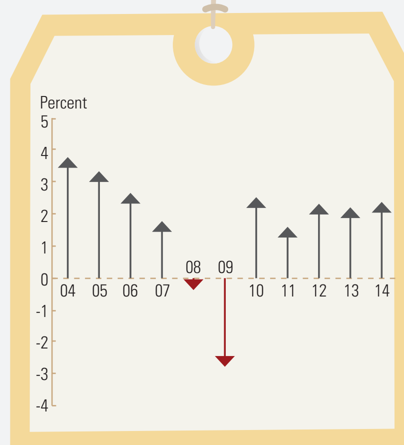
Source: Occupational Outlook Handbook, Bureau of Labor Statistics.

FOR MANY, IT'S A DECADE OF DECLINE

Wages earned by many Americans haven't grown in recent years, even as unemployment has declined. Here, we break down the many decreases and the modest increases in wages by occupation.

For 12 of the 22 major occupation groups tracked by the Bureau of Labor Statistics' Occupational Employment Statistics program, average annual pay* in 2014 was less than it was in 2004. Wondering which "major" group includes your occupation? Visit **www.bls.gov/oes/current/oes_stru.htm**.

Year-over-year change in GDP,* 2004–14[2]



Average annual wage* for all occupations and major occupation groups, 2004–14[1]

Occupation group	Real average annual wage 2004	Real average annual wage 2014	% Change 2004–14
Personal care | Service	$ 27,323	$ 24,980	-8.6
Sales and related ❖	$ 40,370	$ 38,660	-4.2
Production ❖	$ 36,698	$ 35,490	-3.3
Installation | Maintenance | Repair	$ 46,650	$ 45,220	-3.1
Office | Administrative support ❖	$ 36,372	$ 35,530	-2.3
Building | Grounds cleaning | Maintenance	$ 26,934	$ 26,370	-2.1
Transportation | Material moving ❖	$ 34,943	$ 34,460	-1.4
Farming | Fishing | Forestry	$ 25,455	$ 25,160	-1.2
Education | Training | Library ❖	$ 52,741	$ 52,210	-1.0
Healthcare support	$ 29,103	$ 28,820	-1.0
Construction | Extraction	$ 47,026	$ 46,600	-0.9
Community | Social service	$ 45,672	$ 45,310	-0.8
Food preparation | Serving related ❖	$ 21,971	$ 21,980	0.0
Life | Physical | Social science	$ 70,087	$ 70,070	0.0
Protective service	$ 43,667	$ 43,980	0.7
Legal	$ 100,155	$ 101,110	1.0
Arts | Design | Entertainment | Sports | Media	$ 54,784	$ 55,790	1.8
Computer | Mathematical	$ 82,107	$ 83,970	2.3
Business | Financial operations	$ 70,664	$ 72,410	2.5
Management	$ 107,199	$ 112,490	4.9
Architecture | Engineering	$ 77,394	$ 81,520	5.3
Healthcare practitioners | Technical	$ 71,829	$ 76,010	5.8
All occupations	**$ 46,399**	**$ 47,230**	**1.8**

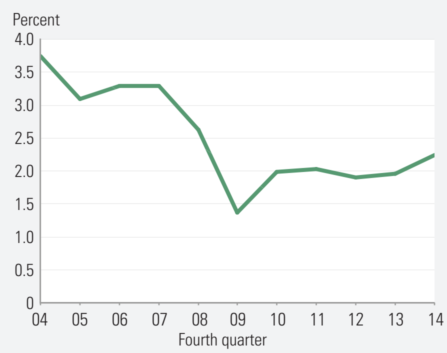
❖ Occupation employed more than 8 million people in 2014

When asked why wage growth—or the lack thereof—matters, Cleveland Fed economist **Joel Elvery** notes that personal consumption accounts for roughly 70 percent of the country's gross domestic product (GDP).

"When wages are flat, it limits the amount of expansion in personal consumption, so it stifles the growth of the economy," he says.

Indeed, GDP and wages have had slow growth in common in recent years.

Growth in compensation costs for US businesses, 2004–14[1]



There's reason for optimism, however. Consider the Employment Cost Index,[1] which is one measure of what employers are spending on labor, including wages and benefits.

In the fourth quarter of 2014, the year-over-year change in compensation grew at a rate (2.25 percent) not seen since the fourth quarter of 2008. In other words: Wage growth has picked up a bit.

*Adjusted for inflation. All wages are in 2014 dollars.
Sources: [1]Bureau of Labor Statistics, US Department of Labor; [2]Bureau of Economic Analysis.

And of course, slow wage growth affects how much people will spend.

"People's personal consumption accounts for about 70 percent of the economy," Elvery says. "When wages are flat, it limits the amount of expansion in personal consumption, so it stifles the growth of the economy."

There's also a familial shock, Holzer asserts. For one, parents who owe child support but are earning less or are not working are less able to meet their commitments. He also notes that college graduates often delay marriage and childbearing until their careers have taken off, and takeoff is taking longer.

In search of skill

It's hard to say when depressed wage growth will lift.

And another Cleveland Fed researcher said as much in a May piece: Using three models for forecasting wage growth, Cleveland Fed vice president Edward S. Knotek II finds evidence suggesting that movements in compensation growth have been essentially unpredictable since the mid-1990s.

But one trend Kelly Services started seeing in the fourth quarter of 2014 bodes well for wage growth and, in fact, was driving wage increases in the first quarter of this year, Carroll says. The average work week is growing for the temporary employee, and if that growth continues, the first tool employers will tap is paying overtime, which drives wage growth.

"Then people get worn out, and then employers will need to hire," Carroll says.

Plus, Kelly Services is seeing an increase in its client employers hiring their temps for full time, a situation which tends to be another driver of wage growth.

For his part, the Cleveland Fed's Occhino expects wage growth to pick up as the unemployment rate, which was 5.5 percent in May 2015, continues to decline and the labor market tightens.

"Recent data on wage growth have been more encouraging," he says, citing the Employment Cost Index, which tracks what employers are spending on labor. Total compensation costs for all civilian workers increased 2.6 percent for the 12-month period ending March 2015 compared to the 1.8-percent increase for the 12-month period ending March 2014.

Modest and gradual wage growth, which Georgetown University's Holzer also expects, doesn't address the long-term and structural problems, though, Holzer notes.

"There's a higher demand for skill, and a lot of workers don't have those skills," he explains. "It's not just more education. In America we love to do that: We send a lot of kids to college and they get there and a lot of them drop out and don't finish, or they don't necessarily get a degree in a high-demand area. It's not more education. It's better education — education and skills that better match the growing sectors of the economy."

The Cleveland Fed's Elvery doesn't see government changing the slow wage growth story, though theoretically it could respond by expanding the social safety net.

A major expansion in education could increase the supply of high-skilled workers and help reduce the number of people competing for low-skill jobs, but "right now what we're seeing is very little change in educational attainment and high change in technology," Elvery says.

"It just leads to this question: What education change would help in this situation?" he poses. "And that is an open question that we should all think about."

KellyOCG's Carroll agrees that the acquisition of new skills will be important to changing the wage trend.

"The supply has to acquire the skills to meet the demand," she says. "We need to get talent out there developing their skills toward what companies need. From a demographic standpoint, many, many tradespeople are retiring. How do we get people to learn the trades to replace the workforce that's leaving?" ■

On the reel

Forefront asks Clevelanders, is wage growth slow for people you know, and what should be done about it? Hear them speak: ***http://tinyurl.com/novvku2***