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5 on 45: Are wages really rising for American workers?

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(MUSIC)

PITA: You're listening to 5 on 45 from the Brookings Podcast Network, analysis and commentary from Brookings experts on today's news regarding the Trump administration.

SHAMBAUGH: I'm Jay Shambaugh, the director of the Hamilton Project here at Brookings.

While economists like to refer to many statistics in their discussions, perhaps the one that means the most to the largest number of people is wage growth. To this end, many observers were encouraged by the most recent Employment Situation Report released on February 2nd which showed a slight uptick in wage growth. However, while Friday's employment report may possibly signal the start of good news on wage growth, I think it's probably too early to say that a trend has begun.

In his first State of the Union address President Trump highlighted the significant growth and progress of the U.S. economy during the last year. As a former member of the Obama White House Council of Economic Advisers, I share the president's enthusiasm for the nation's continued economic growth supported in part by economic policies created during the last decade. In the past year, we've seen a continuation of positive trends including the low unemployment rate and the closing of the jobs gap. While a number of economic indicators are encouraging, many Americans have not benefited from this progress.

Wage growth has been weak for many American workers in recent decades. After adjusting for inflation, U.S. wages were only 10 percent higher in 2017 than they were in 1973 with annual real wage growth just below 0.2 percent. As my Hamilton Project colleagues and I found in a September 2017 report, the wage growth that has occurred has been unequal, primarily benefiting those at the top of the income distribution. Between 1979 and 2016 wages grew significantly in the top two income quintiles yet real wages fell slightly over that same period in the bottom quintile. In addition, nominal wage growth—that visible boost in paychecks—has been weak during this business cycle.

By contrast with previous decades, nominal wage growth has not increased as much as anticipated given the cyclical lows in unemployment that has been reached. Instead it has stayed around 2.5 percent. Now it's important to note that because of low inflation the current business cycle has seen slightly better real wage gains than in previous decades. But that roughly 0.7 percent per year gains since the beginning of the Great Recession is far too weak to make up for decades of stagnation.

The recently released Employment Situation Report showed that overall hourly earnings grew at 2.9 percent over the course of the year which was something that got the attention of bond markets and equity prices. Nevertheless, one data point is too early to argue a trend has begun. A number of times in this expansion there have been brief upticks in wages only to see them flatten out again.

It may be that the labor market after falling unemployment for eight years is finally tight enough that firms need to pay higher wages, but we would need more evidence to know for sure. The fact that minimum wage hikes kicked in in a number of states in January may have also contributed, though, again, more evidence is needed there. Other data sources are also showing rising wages, but all of them show wage growth still well below its level during other periods of strong economic growth.

One disconcerting aspect of the recent increase was the fact that the wage growth for production and nonsupervisory workers, which is roughly the bottom 80 percent of the wage distribution, only increased 2.4 percent which is roughly in line with where it has been for a few years. So we did not see any acceleration for that group.

Given the slow nominal wage growth in 2017 for most workers, and as inflation has moved back up a bit from its very low levels in 2015, real average hourly earnings grew in 2017 at their slowest pace since 2012, and they were well below their average for this business cycle. That is, growth in real wages or people's actual purchasing power has actually ticked down a bit.

Probably the most important thing to remember with all these ups and downs is that over a long stretch of time wage growth has been relatively stagnant and workers share of the economy has been declining. It will take sustained wage growth—higher than even in the last 12 months' bump—to materially reverse that situation.

Stagnant wage growth for the typical worker has not occurred in a vacuum. A number of factors have contributed including declines in labor institutions such as unions, globalization and technological change, decreased dynamism in the business community and labor markets, and increased concentration in product and labor markets. These are complex economic challenges that require a continued commitment to identifying constructive, fiscally responsible solutions in the years ahead.

Policies that merit serious and substantive consideration by policymakers and regulators include reforming labor market institutions, limiting employer collusion, reforming non-compete policies, expanding wage transparency, encouraging worker mobility, improving and expanding technical education, and lifting labor demand through macroeconomic policy. In response, at the end of February, the Hamilton Project will release a new book, "Policy Proposals Aimed at Helping the Average American Worker Get a Raise."

It is always encouraging to witness and celebrate periods of strong economic growth; however, we must also remember that when growth is broadly shared the economy and the country stand to make the greatest gains.

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