

January 11, 2011

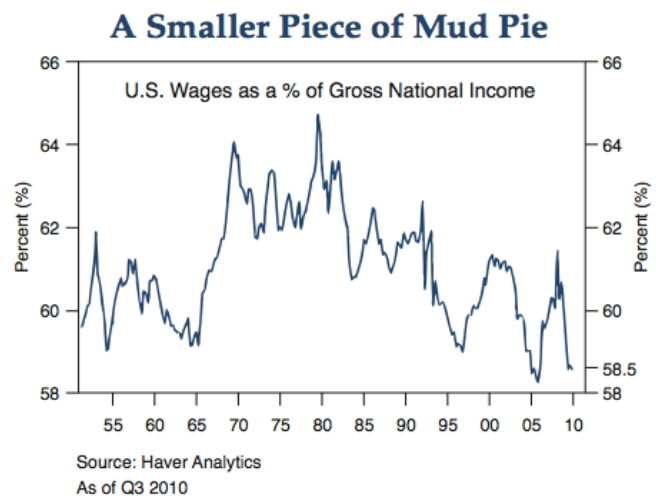
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It is popular to claim workers' share of the income 'pie' is shrinking. Data is often used erroneously to illustrate this point. A careful look suggests this claim is not correct.

Chart 1 recently appeared in a popular investment letter published by Bill Gross of Pimco*. It illustrates a point often made concerning wages paid to US workers. According to Gross, "Blame it on poor education, blame it on globalization, but an ongoing rebalancing of rich country/poor country wages inevitably will keep U.S. wages compressed." Other analysts offer a somewhat less charitable interpretation, claiming the decline in workers' share of total income is 'unfair' and shows employers are not reflecting productivity growth in workers paychecks. A careful look at the data suggests these claims are not correct.

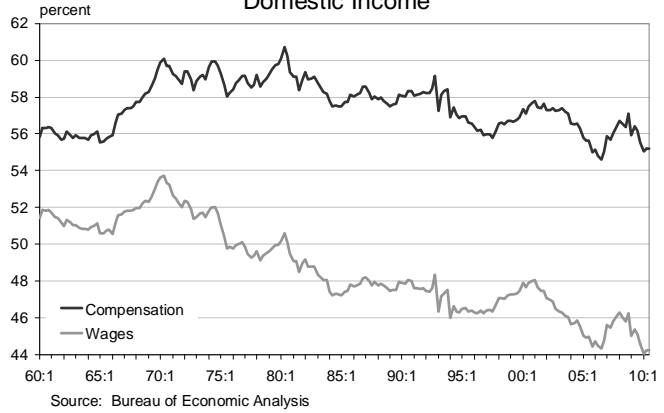
The first point is there is a major difference between wages and compensation. Compensation consists of wages plus benefits. Over the past 40 years, a growing share of compensation is non-wage benefits, the largest of which is health insurance. The US tax system encourages people to obtain their health insurance through their employers, because they can obtain better insurance at a lower cost – employers are not taxed on the money they spend for insurance premiums, but individuals are. As insurance premiums have increased, both employers and employees have made a very rational decision to allow wage payments to be squeezed so medical insurance benefits could increase. The result is illustrated in chart 2. Wages as a share of national income have fallen from about 54% in 1970 to about 44% today. However, compensation has declined from about 60% to about 55% – roughly half as much.

Chart 1*



Another factor underlying the decline in the share of income going to wages is that sources of income have shifted over time (chart 3). Again, the Federal government plays a role. In 1960, only about 6% of personal income came from transfer payments (mostly social security); today, the share is over 18%. As a growing number of baby boomers begin collecting retirement benefits, this share is likely to rise. Over time, a larger share of income has come from interest and dividend payments – up about 6 percentage points over the past 50 years. The growing importance of non-wage income says nothing about international wage comparisons or the competitiveness of US workers – it says much more about public policy and the age structure of the workforce.

Chart 2
Employee Compensation as a % of Gross Domestic Income



What about the charge that productivity gains have been reflected more in corporate profits than in personal income? Again, this charge has little basis. To compare income and productivity gains, one must first adjust for inflation; it is important to use the same measure of inflation to adjust both income and output. Sometimes analysts use income adjusted by the CPI and output adjusted by a production price measure which introduces an apples to oranges comparison problem. The correct comparison is shown in chart 4. During the 60s, 70s, and 80s, income per capita clearly grew faster than output per worker. Rates of growth were similar in the 90s with income outpacing output by a small margin. In the 00s, income did not keep pace with output by a healthy margin. Since income always suffers during recessions and the 00s included the most severe recession in the post war period, it is not clear there has been a shift in longer term patterns. If workers are not earning a ‘fair’ share of productivity growth, this is a very recent development and it may be temporary.

It is quite easy to misuse and/or misinterpret economic data. Chart 1 is an illustration of both.

Chart 3
Shares of Income

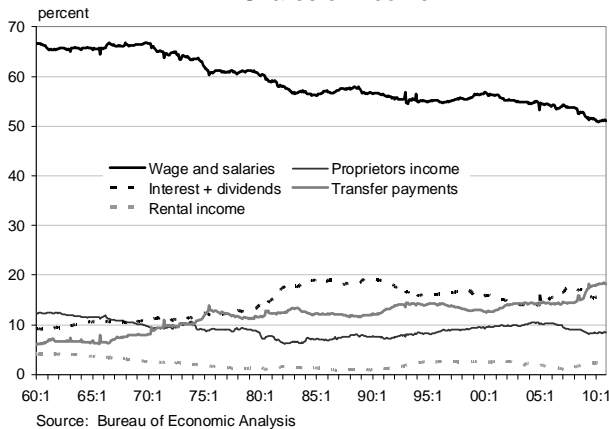
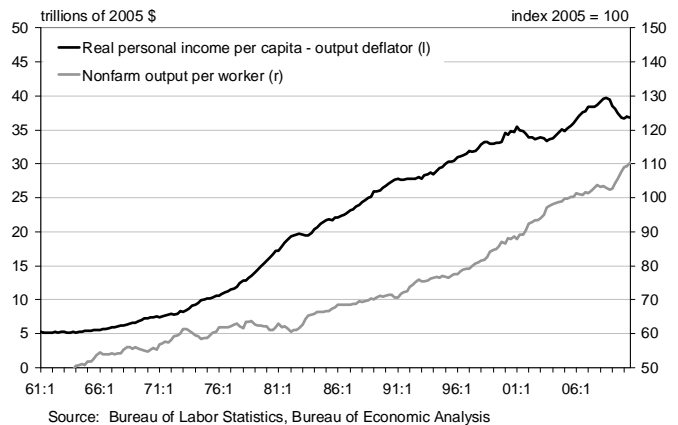


Chart 4
Real Income Per Capita vs. Productivity



* We could not reproduce Chart 1 using the data cited, and neither Mr. Gross nor PIMCO responded to requests for the data used.

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