

Testimony before the Joint Economic Committee

**Hearing on "Examining the Rise of American
Earnings and Living Standards"**

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by

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Measures of Compensation as Indicators of Economic Performance

Good morning Chairman Paulsen, Ranking Member Heinrich and Members of the Committee. Thank you for this opportunity to comment on wages and labor market performance.¹

The American economy is growing again, but many in the media, policy circles, and academia have been puzzled by what appear to be stagnating real wages.² The hourly amount that workers are paid can be an important indicator of economic performance and economic policies. But how wages are measured turns out to greatly affect estimates of their level and trend over time.

Several features of the available wage data provide an incomplete picture. Most national measures of wages focus on a ratio that has cash earnings in the numerator and a denominator of either time worked or time paid, measured in hours or weeks. Wage changes are then calculated as the difference between the current value of such a measure and what this measure was in a previous month or year. But because cash earnings do not include the important fringe benefits available in many jobs, and the usual measures neither net out payroll and income taxes owed as a consequence of working, this approach misses an important part of the economic value of work for the worker and his or her family. Moreover, cash earnings are naturally measured in dollars and are thus affected by changes in the value of a dollar over time due to inflation.

In addition to the difficulty with focusing on cash earnings in the numerator, the denominator in the calculation poses additional challenges for an accurate assessment of wage changes. Although not all wage data do so, it is important to distinguish between hours paid and hours worked, because a number of employers pay their employees while they are not at work—on vacation, sick leave, or parental leave. As is recognized in the Bureau of Labor Statistics (BLS) productivity statistics, hours worked rather than hours paid is the proper denominator for measuring either productivity or what a worker received per hour worked (BLS 2015).

All the current data measures begin with a sample of individuals who happen to be employed at the time of the survey (or a sample of jobs held by those individuals). But the people employed today make up a somewhat different group than those who were employed last year, and a quite different group than those who were employed a decade ago (Jeong, Kim, and Manovskii 2015). Movements of people in and out of the workforce systematically bias

¹ My testimony is based on a recent report issued by the Council of Economic Advisers entitled “How Much Are Workers Getting Paid? A Primer on Wage Measurement” available at <https://www.whitehouse.gov/wp-content/uploads/2018/09/How-Much-Are-Workers-Getting-Paid-A-Primer-on-Wage-Measurement-Sept-2018.pdf>

² See Long (2018), OECD (2018), Chetty et al. (2014), and Guvenen et al. (2017), respectively.

the usual wage growth measures away from being reliable indicators of individuals' experiences.³ Every year young, inexperienced people enter the workforce, and thereby they are included for the first time in the national average, at wages below those of more experienced workers.⁴ And every year, some of the most experienced, and highly paid, workers retire and thus cease to be included in the national average. Both these life cycle events substantially reduce the national average wage, especially now that Baby Boomers are retiring. All these issues can be addressed, and valid inferences can be obtained, by properly using the various publicly available wage data.

The recent BLS fringe-benefit data show how workers have been receiving bonuses, which contribute to the growth of their compensation but are not included in the headline wage measures. The data also show how employers have been providing more paid time off, which means that earnings per hour worked is increasing more than earnings per hour paid. Health insurance, on the other hand, has not significantly added or subtracted from recent compensation growth rates.

Holding the composition of the workforce constant, the annual growth rate of real compensation over the past year (2017:Q2–2018:Q2) has been almost 1 percentage point higher than the usual wage measures deflated with the Consumer Price Index (specifically, the Consumer Price Index for Urban Consumers, CPI-U). In other words, real wages grew 1.0 percent rather than the 0.1 percent that is usually reported from the monthly “Real Earnings” release.

Moreover, taking into account the personal income part of tax reform (the Tax Cuts and Jobs Act of 2017), after-tax real (after inflation) compensation grew 1.4 percent over the past year, well above the near-zero real wage change suggested by headline measures.

I want to be clear that this analysis is not a critique of the Federal bureaus that provide us such excellent data. The Federal agencies are providing a number of data products that address each of the things I mentioned today. The problem is that these additional products get too little attention when it comes to assessing how the labor market is performing.

When the average real household income grows at 1.4 percent per year, that means an additional \$1,000 every year, beyond what is required to keep up with inflation. The additional income is even greater when we recognize that the average household now has more members with jobs and that each worker is accumulating work experience over time that translates in to yet higher pay. None of this is a surprise given that recent Federal policies have been encouraging business formation and removing disincentives to work.

³ Similar approaches are sometimes used to measure labor productivity or employer cost: taking output or compensation per hour worked without any adjustment for changes in the composition of the workforce. Much of the discussion that follows therefore applies to the measurement of labor productivity and employer cost.

⁴ “Workforce” refers to the set of people employed (although not necessarily at work, because they could be on paid leave), which differs from the labor force in that the workforce excludes the unemployed.

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