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American wage (under)regulation

Official statistics show that US real consumer wages have developed weakly over a longer part of the post WW-II period than is commonly believed. For example, in 2016, the median male wage earner has a lower wage in real terms than forty years ago, U.S. Census Bureau data shows. It is easy to imagine that this secular development, so different from the first post WW-II decades, as one of the factors that fed the American working families' taste for credit financed consumption during the Great Moderation and before. Hence, possibly also as a factor behind the sub-prime crisis and the financial crisis, and even preparing the ground for the appeal of Trump's promises to make good time come back.

What lies behind the weak performance of American real wages? The development is hardly a historical necessity. Neither is it forced upon USA by lack of resources, or by foreign powers. The system for wage fixing in USA is therefore a candidate worth considering,

Some years ago, Gunnar Bårdsen and I did a project on the natural rate of unemployment in USA.[1] As part of that project, we modelled nominal wage adjustment. In economies where collective agreements regulate a major part of wage growth, and the wage norm of the economy is fixed in the manufacturing sector, it is reasonable to expect that the trend of the real wage per hour will be close to the trend of average productivity per man-hour. However, in the USA, the private sector unions have not been strong enough to leave a clear mark on the wage setting at large. Instead, the wage development at the macro level is a summation of an immense number of individual wage contracts and agreement, with very little attempt to achieve any degree of coordination or ``wage policies'' by organizations or government. In such a system, the theory of efficiency wages probably fits better that the theory of collective bargaining power. This theory says that wage earners may expect to receive compensation for increases in cost of living and that they receive efficiency motivated individual compensation. However, there is no easy to see implication of this theory that the consumer real wage will grow according to average labour productivity.

In our project, we had data from the first part of the 1960s until 2004. Our estimation results showed that the American real wage target only increased by 0.2 percent when productivity increased by one percent. This result indicates that the model we developed could predict a real wage path with the same meagre development over time as the U.S. Bureau Census data shows is what actually has happened.

[1] G. Bårdsen og R. Nymoen: US Natural Rate Dynamics Reconsidered, Chapter. 16 i The Methodology and Practise of Econometrics. A Festschrift in Honour of David F. Hendry. J.L. Castle og N. Shepard (red), Oxford University Press, 2009.

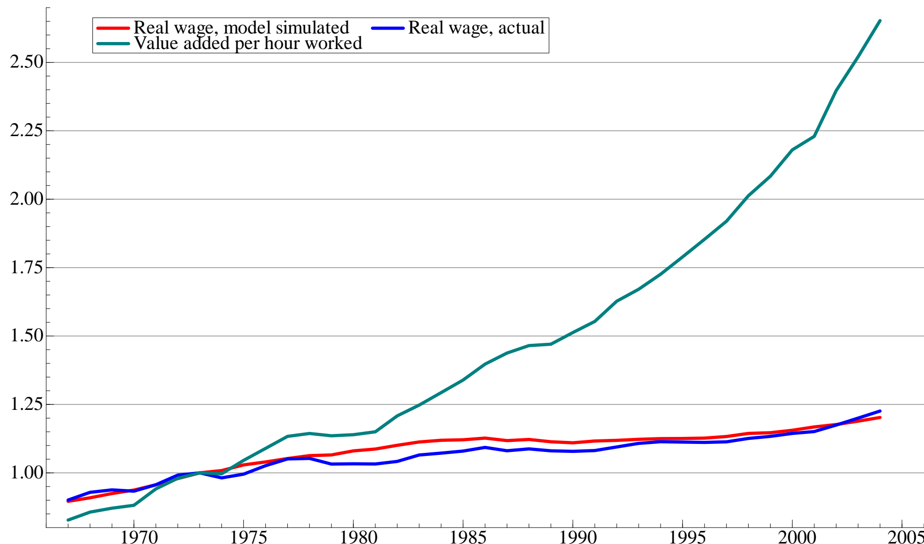

Figure: Real wage per hour and value added per hour. Indices with base-year 1973 (1973 =1) .

I have therefore re-analysed the data from the “US-natural rate” paper and calculated the real wage path that our model implied. This involves simulation of a system of equations since the model treated nominal wage and price adjustments as interrelated processes (and with unemployment as well). The real wage is a variable that both firms and workers take a huge interest in controlling, but which neither of them can actually control in the decision processes that they participate in, namely about nominal wage changes and about nominal price changes.

In the figure, the actual wage development (in blue) shows wage per hour in manufacturing divided by the consumer price index. The graph of model simulated real wage (in red) tracks the actual development well, while both real wage graphs lose all connection to the productivity trend (in green). The disconnection happens early, in the 1970s, or early 1980s at the latest. Based on this calculation, the American manufacturing worker could have hoped for 100 percent higher wages in 2004 that he actually received, if the connection to productivity trend had been in place during the last decades of the last millennium.

There are several questions that can be raised in connection to this observation. The increasing number of private-sector employees participating in different forms of “shared capitalism”, which have in common that that workers receive a share in profits or stock appreciation when the company makes a profit, may mean that total work-related income is more closely linked to productivity than hourly wages appear to have been. Moreover, one can argue that if the anchoring of wages in trend productivity had been achieved in a labour market with strong worker unions, the productivity growth might have suffered. These is no clear answer to this question, but the effect would have to be very large in order so substantially reduce US firms ability to compensate their workers. Hence, there is reason to believe that the meagre growth in US wages may have less to do with product market liberalization, international trade and the Washington elite’s “conspiracy’’ and more with the US system of labour market regulation?

(The post is a revised version of a signed piece in the Dagens Næringsliv 16. November 2016)