Armchair Economics

Perspectives from an economic everyman

Why Wages Have Stagnated
June 2017

There has been a lot written over the last few years about wage stagnation. The general story is that wages have not kept up with inflation for maybe as long as a couple of decades. Instead of digging into wage data to rehash what many mainstream economists have already done, let's consider what they haven't done. **Why have wages struggled to grow?** The Armchair of course has a theory.

Let's begin by remembering that all the analysis of wage growth has been focused on general averages. You take the total number of people employed, divide that by the total wages paid and you get the average wage. This seems simple enough, but maybe not so revealing when an economy has transitioned from manufacturing to service driven.

Although the Bureau of Labor Statistics (BLS) data only goes back to 1990, it's not too hard to understand the historical make up of jobs in this country.

Before 1900, when the country grew from the original 13 colonies to encompass most of the geography we know today, a significant number of jobs were in agriculture and construction. Prior to technological advances in agricultural machinery, the family farm was a common economic unit. Then as population migrated westward, transportation routes and towns had to be constructed.

Early last century, we experienced a rather dramatic transition from agriculture to manufacturing, as innovations like distributed electricity, telecommunications and automobiles began to proliferate. The requirements of World War I nudged manufacturing forward, while the requirements of World War II and its ensuing boom years caused a manufacturing explosion.

Simultaneously fighting two major wars in two distinctly different parts of the world required the production of all manner of war equipment—battleships, tanks, planes, various vehicles, bombs, guns, bullets, as well as the food, clothing and shelter needed to support the troops. Post World War II, our soldiers came home to a reasonably well-oiled production economy that then produced cars, houses and all the appliances and accoutrements nesting Baby Boomer parents demanded.

Post World War II America was also responsible for rebuilding the world—Europe, Japan and Southeast Asia had been decimated. American manufactures built the lion's share of the first wave of reconstruction equipment that restored much of those regions.

For a time, the U.S. was the manufacturing center of the world, led by the Upper Midwest Great Lakes region. Pittsburgh was the world's steel center. Detroit was the world's auto center. GE, Maytag, Kenmore and others were the envy of appliance manufacturers around the world.

After our post-war financial support programs in Europe and Japan kicked in, those economies began contributing more and more to their own rebuilding efforts. By the 1960s, these economies were even selling some products on our own shores

For those old enough to remember, the first Japanese cars that came to the U. S. were no more than "tin cans on wheels." Our carmakers and consumers laughed out loud at their meager attempts and offerings. But this was all their fledgling manufacturers could produce after being devastated in the war.

Today we look at Japanese cars and electronics, as well as German cars and machine tools, as the highest quality in the world. (Don't forget that China seeks to follow suit.)

As Europe and Japan recovered, their manufacturing industries grew stronger and more productive. We all know the end of this story—as Europe's and Japan's manufacturing centers grew, the U.S. began shifting more and more to a service economy.

This transition from manufacturing to service based economy is likely why wages in the U.S. have struggled to keep up with inflation. Let's dig into the numbers to understand why.

The BLS keeps track of employment in the U.S. Unreported by virtually all economists is an aggregation of jobs that the BLS has been tracking for many years.

The BLS aggregates jobs into three major sectors: Goods Producing, Service Providing and Government. For the sake of understanding wage stagnation, we are only going to consider nonfarm private sector jobs and exclude government jobs. Here is how the BLS aggregates and separates jobs:

Goods Producing industries include:

- Agriculture, Forestry, Fishing and Hunting
- Mining, Quarrying, and Oil and Gas Extraction
- Construction
- Manufacturing

Service Providing industries include:

- Wholesale Trade
- Retail Trade
- Transportation and Warehousing
- Utilities
- Information
- Finance and Insurance
- Real Estate and Rental and Leasing
- Profession, Scientific and Technical Services
- Management of Companies and Enterprises
- Administrative and Support and Waste Management/Remediation Services
- Educational Services
- Health Care and Social Services

- Arts, Entertainment, and Recreation
- Accommodation and Food Services
- Other Services (except Public Administration)

Analyzing the data tells us that in 1990 we had one Goods Producing job for every 3.62 Service Providing job. In 2016 we had one Goods Producing job for every 6.31 Service Providing job. (An old 1980 labor economics essay I found provided 1979 data showing that back then we had one Goods Producing job for every 2.39 Service Providing job.)

For those who have kept up with economic news, this information shouldn't be surprising. Article upon article about economy over the last two to three decades has talked about the U.S. economy shifting from manufacturing to service. (That 1980 article specifically addressed this topic.)

But there's a rub when we look at related wage information.

According to the BLS, total average hourly compensation for a Goods Producing job in 2004 (the earliest data available) was $27.65. That same year, the total hourly average compensation for a Service Providing job was $22.58. Today the total average hourly compensation for a Goods Producing job is $38.74, while it is $31.04 for a Service Providing job.

Since at least 2004, Goods Producing jobs have paid more than Service Providing jobs. (It's not a stretch to assume the difference was even larger during the manufacturing "union" days.) The actual difference in total wages between these two classifications has not changed much from 2004 to 2016. Service Providing jobs on average paid 81.66% in 2004 and 80.12% in 2016 of Goods Producing jobs. (As you can see it has actually declined).

The conclusion is pretty simple. **We've been creating a lot more lower-paying (Service Providing) jobs than we've been creating higher-paying (Goods Producing) jobs**.

In 1979, we had 2.39 Service Providing jobs for every Goods Producing job. In 1990, we had 3.62 Service Providing jobs for every Goods Producing job. In 2016, we had 6.31 Service Providing jobs for every Goods Producing job. The growth of these lower-paying jobs is what drags down overall average wage growth.

Further wrinkling the brow should be how wages at very well-paying Service Providing jobs can skew wage data. Investment banking, banking, law, investing, consulting, various forms of brokerage, and then all those highly paid media and information-oriented industries help bring average Service Providing wages up. Even with all these high paying professions, Service Providing jobs on average still pay lower than Goods Producing jobs. Imagine if you are an "average" person in services? Your pay has surely not kept up with inflation.

Average wages have not been able to keep up with inflation in this country because our economy is too Service Providing and not enough Goods Producing. Given how technology continues to replace more and more jobs in both sectors, the implications here are a can of worms—and for another musing. Right here, we are just trying to understand why average wages have not been able to keep up with inflation, even as subdued as it has been over the last decade.

Furthermore, since average wages for a growing number of people have been unable to keep up with inflation, our economy has become dependent on ever more government deficit spending (read…debt) as well as monetary stimulus (read…money printing) to keep the wheels on the bus.

The solution to wage stagnation and our overall economic challenges is not that simple given technology's current influence. But at minimum, we need to reverse the trend of the last few decades. The country needs to make more stuff. So, no matter how critical of or embarrassed by our president we may be, his America First agenda is a very positive step in the right direction.

Doug

Douglas A, Leyendecker
713-862-3030
doug@armchaireco.com