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Workers' Compensation Growing with Their Productivity

James Sherk

Americans frequently hear that workers work harder than ever, but do not reap the fruits of their labor. A simple comparison of productivity and wage growth seems to confirm this trend. However, productivity and wage growth are not directly comparable. Looking at everything workers earn—not just cash wages—and adjusting both series with the same measure of inflation shows that productivity and compensation have risen in tandem. In fact, workers' pay is more directly tied to their performance than a generation ago. Congress should not legislate to correct an imbalance between wage and productivity growth because this difference does not exist.

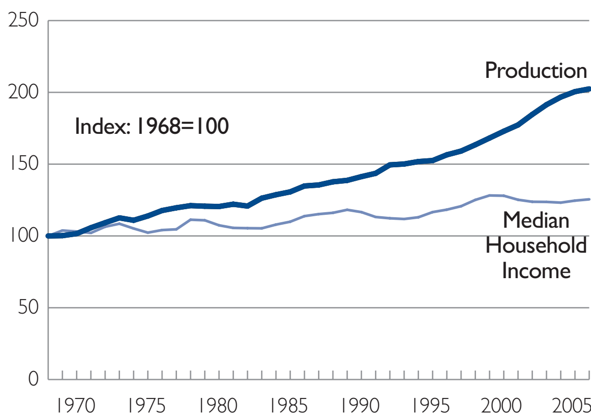
Gap Between Wages and Productivity. Many analysts contend that there is a widening gap between what workers produce and what workers earn. They point out that workers' productivity has risen sharply over the past 40 years, but wages have not risen nearly so quickly.[1] This concern also appears frequently in the news, especially with the current economic troubles.[2] A superficial look at the data appears to validate these concerns. Chart 1 shows the growth of productivity and median family incomes since 1968. While productivity has more than doubled, median incomes have risen only 26 percent.

It appears that wages have not risen in step with productivity. This appears to contradict economic theory, which says that competition will force companies to raise workers' pay when productivity increases. Many commentators suggest sharehold-

Productivity and Income

Median household income, adjusted for inflation using the Consumer Price Index, does not appear to have grown as fast as productivity.

Production and Median Household Income, 1968-2006, Using the Consumer Price Index



Source: Heritage Foundation calculations using data from Haver Analytics/Census Bureau and the Bureau of Labor Statistics, inflation adjusted using the CPI-U-RS.

Chart 1 • WM 1943 heritage.org

This paper, in its entirety, can be found at:
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(202) 546-4400 • heritage.org

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ers and CEOs are appropriating the gains from workers' increased productivity for themselves.[3] Workers are baking a bigger pie, so to speak, but eating smaller slices.

Apples to Oranges Comparison. This picture is misleading because comparing wage and productivity growth is like comparing apples to oranges. The two are not directly comparable for two reasons.

First, the government measures productivity and wage growth differently. The Bureau of Labor Statistics uses a different method to adjust productivity for inflation than it uses to adjust wages.[4] A simple comparison of these two series reveals the differences between these two measures of inflation, not the actual difference between wage and productivity growth.

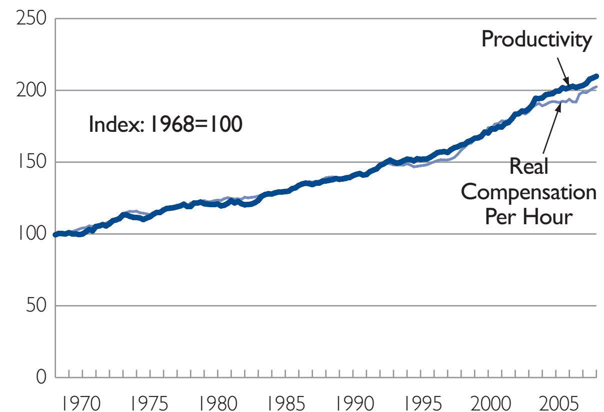
Second, wages are only part of what workers earn. Benefits, such as health coverage, 401(k) plans, and paid sick leave are an increasingly large part of workers' earnings. Economic theory says that companies will raise workers' earnings when their productivity rises, but it does not say that those increased earnings will take the form of cash wages. The correct comparison is between productivity growth and workers' total compensation, including benefits, not just the cash wages portion of that compensation.

No Gap Between Compensation and Productivity. To make an apples to apples comparison of productivity and workers' pay, one needs to look at total compensation, and use the same measure of inflation to adjust both series. Chart 2 shows such a comparison. Over the past forty years compensation per hour and output per hour—that is, productivity—have moved almost in unison. Productivity rose 110 percent since 1968, and total compensation rose 103 percent.

Productivity and Real Compensation Per Hour

When making comparisons using the same measure of inflation and measuring everything workers earn, compensation rises with productivity.

Productivity and Real Compensation Per Hour, 1968-2008, Using the Implicit Price Deflator



Source: Heritage Foundation Calculations based on data from the Department of Labor, Bureau of Labor Statistics/Haver Analytics; compensation per hour adjusted using the Implicit Price Deflator.

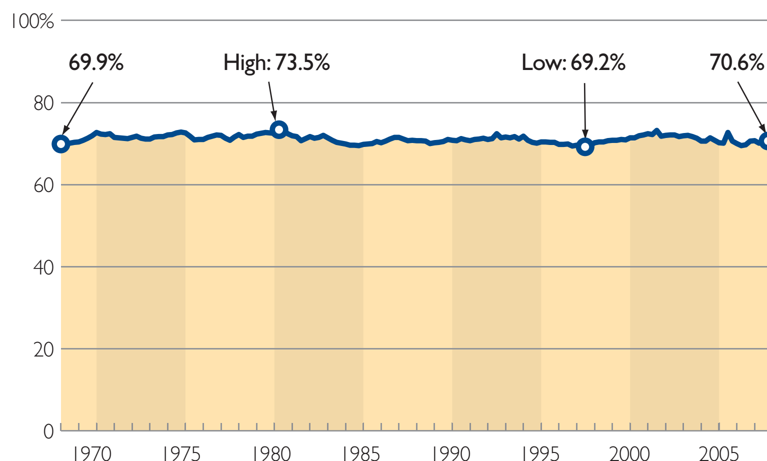
The gap between wages and productivity exists only because some analysts compare figures that are not directly comparable. Making the correct comparison eliminates that gap. As workers become more productive, competition for these increasingly productive workers forces businesses to pay their employees more.

Workers' Share of Income Constant. More evidence that the gap between earnings and productivity is illusory comes from looking at employees' share of national income. If workers have become

1. See Jared Bernstein and Lawrence Mishel, "Economy's Gains Fail to Reach Most Workers' Paychecks," Economic Policy Institute *Briefing Paper* #195, September 3, 2007, at *http://www.epi.org/content.cfm/bp195* (May 30, 2008).
2. Greg Ip, "Wages Fail to Keep Pace with Productivity Increases, Aggravating Income Inequality," *The Wall Street Journal*, March 27, 2006, at *http://online.wsj.com/public/article/SB114341649383308604-nD9yJIDaBrnnGoDZYhxAfVf7Sbg_20070326.html* (June 2, 2008).
3. See for example Eileen Appelbaum, Testimony before the Committee on Education and Labor, U.S. House of Representatives, January 31, 2007, at *http://edlabor.house.gov/testimony/013107EileenAppelbaumtestimony.pdf* (May 30, 2008).
4. The Consumer Price Index is used to adjust wages for inflation, and the Implicit Price Deflator is used to adjust productivity growth for inflation.

more productive and businesses have not paid workers for their increased productivity, then workers' share of national income would fall. Someone else—such as business owners or shareholders—would be reaping the financial gains from workers' heightened productivity. This has not happened. Chart 3 shows employee compensation as a percent of national income over the past four decades.

Employee Compensation as a Percentage of National Income



Source: Heritage Foundation calculations based on data from the Department of Commerce, Bureau of Economic Analysis/Haver Analytics.

Note: Proprietors' income is excluded from national income to avoid complications in allocating proprietors' income between labor and capital.

Over the past 40 years the compensation that companies pay their employees has held constant at slightly over 70 percent of national income, never deviating more than a few percentage points from that number. In the first quarter of 1968 employee compensation was 69.9 percent of national income. In the last quarter of 2007 it was 70.6 percent. Business owners are not denying workers the fruits of their labor.

Wages More Strongly Tied to Productivity. In fact, the opposite has happened. Businesses have dramatically increased their use of performance-based pay, such as commissions, piece-rate pay, and performance bonuses, over the past generation. Workers are much less likely to be paid just an annual salary or hourly wage than in the past. Between 1976 and 1998 the proportion of jobs using some method of performance pay rose from 30 percent to 45 percent.[5] Today half of all salaried workers receive performance pay. The increase in performance-based pay explains almost all the increase in inequality among the top fifth of income earners. Workers' pay today is more directly tied to their productivity than ever before.

Conclusions. There is no gap between productivity and compensation. Simple comparisons of productivity and wage growth are misleading because the two data sets are not directly comparable. The government uses different measures of inflation to adjust wages and productivity for inflation and wage measurements do not include benefits. Looking at total compensation, not just cash wages, and using the same measure of inflation shows that both compensation and productivity have doubled over the past 40 years. The share of national income that goes to workers' compensation has also stayed constant. Employers are not hoarding the gains from workers increased productivity. Workers' pay is actually more closely tied to their productivity now than in the past. Congress should not legislate on the mistaken belief that workers' earnings are lagging behind productivity.

—James Sherk is Bradley Fellow in Labor Policy in the Center for Data Analysis at The Heritage Foundation.

5. Thomas Lemieux, W. Bentley MacLeod, and Daniel Parent, "Performance Pay and Wage Inequality," NBER Working Paper No. 13128, May 2007, p. 17, at *http://papers.nber.org/papers/w13128* (NBER subscription required).