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American Wages Have Grown

Admiration of the performance of the American economy is widespread, especially of its low unemployment rate. But it is also widely reported, especially in Europe, that this enviable unemployment rate has been purchased at the expense of a decline in the real wages of the average American worker over the past few decades. Thus the difference between Europe and the USA is sometimes cast in terms of wages versus unemployment.

I would like to put the record straight -- or at least cast skepticism on this now conventional view. Widely cited, on both sides of the Atlantic, is the official series on the average real weekly wage in the United States, which shows a decline of 14 percent over the period 1970-1996. (I choose 1996 because unemployment was declining toward five percent, and because it excludes the significant increase in real wages during the past year.)

Against that apparently miserable result must be put another: an increase in American real consumption per head by 66 percent, or nearly 2 percent a year, over the same period. This suggests that the material well-being of the average American improved substantially. How can both figures be right?

The explanation, as often, is complicated, involving both concept and measurement. Over this quarter century the American economy experienced higher rates of participation in the labour force, especially by women, and a decline in the share of children in the population; a relative growth of non-wage income, especially but not exclusively pension income; and lower savings rates. Allowing for these factors implies an increase in the average real wage rate of nine percent, still way above the official figure.

But the official real wage figures have several known downward biases to them, which are

far too often ignored. First, the “real” wage is calculated using a price index with a widely known mistake in it, due to incorrect measurement of housing costs. The error was corrected in 1983, but not for preceding years, leaving it eight percent too high in 1996 compared with 1970. Second, the wage figure excludes fringe benefits, especially health care, which since 1970 have been increasingly shifted from wage-earners to insurers. Third, the series covers hours paid rather than hours worked, thus excluding the substantial increase in paid vacations. Fourth, the series excludes bonuses. Finally, the series was broadened over time to include many small, low-wage firms. Thus the data have been improved, but the series records excessively high average wages twenty-five years ago, imparting a downward bias to recorded changes in average wages. Taken together, all these factors are quantitatively significant.

Moreover, the official wage series covers only “production and non-supervisory” workers, which in principle covers most American non-agricultural employment, excluding many of those with higher-than-average education; but in actual fact (due to reporting errors) probably excludes many high-paying non-supervisory workers that are not covered by the US Fair Labour Standards Act.

All this makes no allowance for the widely acknowledged upward bias in the US consumer price index, by perhaps one percent annually according to the Boskin Report. Allowing for that alone would raise the real wage by 30 percent since 1970. But there is a great difference between acknowledgement of a bias and meticulous correction of it.

When all these factors are put together, the evidence is overwhelming that the average American worker is materially much better off than s/he was a quarter of a century ago. European (and American) statements to the contrary are misinformed or tendentious.

That does not gainsay that the distribution of income in the United States has widened, a wholly different issue. Moreover, it is quite possible that an 18-year-old man without a high

school degree enters employment today with a lower real wage, even after making all the corrections mentioned above, than his counterpart 25 years ago. But this possibility is mitigated by the fact that only around ten percent of new entrants to the labour force are in this condition today, compared with twice that fraction in 1970.

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