The Daily Dish

Wage Growth

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Eakinomics: Wage Growth

Yesterday the Bureau of Labor Statistics (BLS) released the Employment Cost Index (ECI) for the third quarter of this year. The ECI measures total compensation — wages plus benefits — paid to workers, and is the most accurate measure of compensation growth because it controls for the changing mix of skills and occupations. Unfortunately, this degree of accuracy takes time; the ECI is available only every three months. In contrast, this Friday the BLS will release average hourly earnings for October. This report gets a lot of attention because it is released monthly, but in the current environment it is a less reliable indicator for two reasons. First, it does not cover non-wage benefits that contribute to workers' overall well-being. Second, the labor market has been remarkable in creating roughly 200,000 jobs monthly. In the process, it has pulled into employment and the labor force as a whole workers who are much more marginal — fewer skills and less experience. These workers tend to make less and thus pull down the average.

What, then, did we learn from the ECI? Over the 12 months ending in September, overall compensation in the private sector grew 2.9 percent, the same year-over-year pace as in the second quarter. (The first quarter growth was 2.8 percent.) This is up from roughly 2 percent from two years ago and the fastest rate in a decade. The tight labor market is, indeed, delivering higher pay.

Cash wages grew even faster — 3.1 percent — while benefits grew 2.5 percent. The government sector, in contrast, has slower overall growth at 2.5 percent and the opposite pattern of faster benefits growth (3.1 percent) than wage growth (2.3 percent).

Now comes the hard part. Sustained faster compensation growth means one of two things: (a) firms accommodate the higher costs with thinner profit margins and lower earnings (other things equal), or (b) upward pressure on prices. Neither prospect is uniformly appealing. The way out of this economic box is more rapid productivity growth. As each worker produces more, it is possible to use this greater value to cover the compensation costs. On this front, labor productivity grew 2.9 percent in the second quarter and was up 1.3 percent over a year earlier. This is good news compared to the 0.7 percent annual average since 2010.

Too much attention has been paid to the growth rate of wages. The much more important issue is the future path of productivity.