The Future of Work: Why Wages Aren't Keeping Up

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Robert Solow, *Pacific Standard*, Aug 11, 2015

New cars built in Detroit loaded for rail transport, 1973. (Photo: Environmental Protection Agency)

One of the more puzzling and damaging features of the American labor market in the last few decades has been the failure of real (i.e. inflation-adjusted) wages and benefits to keep up with the increase in productivity. In the years after the Second World War, real wages generally rose at the same rate as output per hour worked. This rough balance was made explicit in what came to be called the Treaty of Detroit: the agreement between the United Auto Workers and General Motors (followed by Ford and Chrysler) that the average annual rate of wage increase would be the percentage increase in productivity plus the percentage increase in consumer prices. This norm spread beyond the auto industry. It had the arithmetic consequence that the share of total value added in industry going to labor would stay roughly constant, with the rest going to the capital side.

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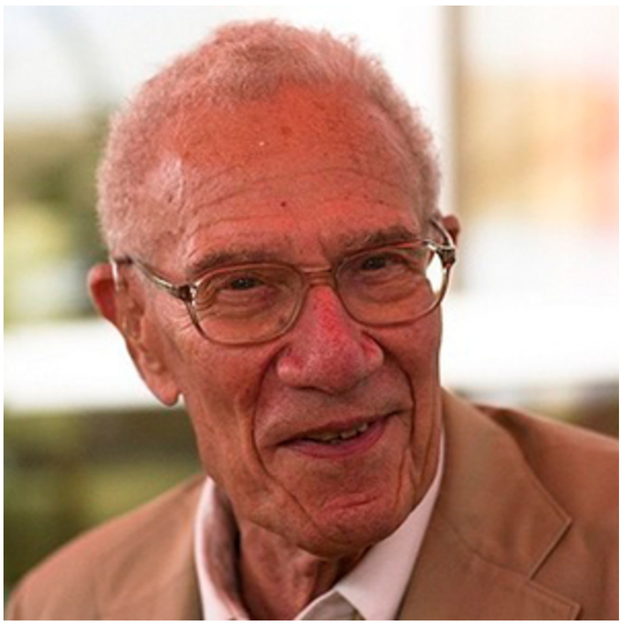
This balance no longer holds. To illustrate, in the past 10 years productivity has increased 12.3 percent in the non-farm business sector of our economy while real compensation of labor has increased by only 5.1 percent. One has to wonder why this happened and whether it is likely to continue. I want to suggest one possible cause for the lag of wages behind productivity. It is not the only one, for sure. But it is particularly interesting, and it interacts with another rather unhappy trend in the labor market to suggest that the trend against wages is likely to continue. (During the past year and a half, real compensation has outrun productivity, but it is much too soon to guess whether this reversal merely reflects dismal productivity performance and other short-run factors or something more durable.)



The custom is to think of value added in a corporation (or in the economy as a whole) as just the sum of the return to labor and the return to capital. But that is not quite right. There is a third component which I will call “monopoly rent” or, better still, just “rent.” It is not a return earned by capital or labor, but rather a return to the special position of the firm. It may come from traditional monopoly power, being the only producer of something, but there are other ways in which firms are at least partly protected from competition. Anything that hampers competition, sometimes even regulation itself, is a source of rent. We carelessly think of it as “belonging” to the capital side of the ledger, but that is arbitrary. The division of rent among the stakeholders of a firm is something to be bargained over, formally or informally.

This is a tricky matter because there is no direct measurement of rent in this sense. You will not find a line called “monopoly rent” in any firm’s income statement or in the national accounts. It has to be estimated indirectly, if at all. There have been attempts to do this, by one ingenious method or another. The results are not quite “all over the place” but they differ. It is enough if the rent component lies between, say, 10 and 30 percent of GDP, where most of the estimates fall. This is what has to be divided between the claimants—labor and capital and perhaps others. It is essential to understand that what we measure as wages and profits both contain an element of rent.

The purpose of the Treaty of Detroit was to freeze that allocation. What happens to it now is not so much a matter of economic law. It depends on bargaining power, business attitudes and practices, social norms and public opinion.

The suggestion I want to make is that one important reason for the failure of real wages to keep up with productivity is that the division of rent in industry has been shifting against the labor side for several decades. This is a hard hypothesis to test in the absence of direct measurement. But the decay of unions and collective bargaining, the explicit hardening of business attitudes, the popularity of right-to-work laws, and the fact that the wage lag seems to have begun at about the same time as the Reagan presidency all point in the same direction: the share of wages in national value added may have fallen because the social bargaining power of labor has diminished. This is not to say that international competition and the biased nature of new technology have no role to play, only that they are not the whole story. Internal social change and the division of rent matter too.

Now I would like to connect this hypothesis with another change taking place in the labor market. Lacking anything more euphonious, I will call it the casualization of labor. The proportion of part-time workers has been rising: both those who prefer it that way and those who would rather have a full-time job. So is the number of temporary workers, whether employed through agencies or on their own. So are the numbers of workers on fixed-term contracts and independent contractors, many of whom are doing the same work as they once did as regular employees. These are all good-faith members of the labor force; they are employed but without what used to be thought of as a regular job.

This shift toward more casual labor interacts with the issue of the division of rents. Casual workers have little or no effective claim to the rent component of any firm’s value added. They have little identification with the firm, and they have correspondingly little bargaining power. Unions find them difficult to organize, for obvious reasons. If the division of corporate rents has indeed been shifting against labor, an increasingly casual work force will find it very hard to reverse that trend.

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For the Future of Work, a special project from the Center for Advanced Study in the Behavioral Sciences at Stanford University, business and labor leaders, social scientists, technology visionaries, activists, and journalists weigh in on the most consequential changes in the workplace, and what anxieties and possibilities they might produce.