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OPINION

Solving the Puzzle of Stagnant Wages

Evidence points to growing government regulation like Dodd-Frank and policies that discourage investment.

PHOTO: CORBIS

By **EDWARD P. LAZEAR**

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The elation over wage increases in private business reported in last month's job report has been replaced by disappointment. The Bureau of Labor Statistics reported on Jan. 16 that average hourly earnings fell five cents in December, eating up most of the six-cent increase in November. Between 2010 and 2014, the average real wage fell 1.1%, a poor showing after rising 3.4% between 2006 and 2010. What accounts for this performance?

There are basically two ways that the average economywide wage can fall. There might be a shift in employment away from high-paying to lower-paying industries; in other words, the economy is producing more "bad jobs." The other way is that the overall composition of work might be the same, but wages for the typical job in most sectors have fallen.

Normally, economywide wage changes reflect what happens to the wage of the typical job. But between 2010 and 2014 there were also significant declines in the proportion of the workforce employed in two high-paying industries. Those declines contributed to overall wage declines—and they may have been caused by policy mistakes.

The share of the private workforce employed in the BLS-defined industries "financial activities" and "hospitals" decreased by about 5% between 2010 and 2014. Jobs in these industries pay 29% and 24%, respectively, above the economy mean. Because a smaller share of labor is working those high-wage industries, the typical job in the economy is now lower-paying than in 2010.

Nevertheless, the movement of workers out of these two high-wage sectors has been partially offset by increases in other high-wage industries. For example, mining, which benefited from the transformation in oil and gas extraction technology and which pays average wages comparable to those in finance, grew significantly. But because mining employs only about one-tenth the number of workers as finance, even large increases in mining don't make up the difference.

So what accounts for the relative decline in jobs in high-wage hospitals and finance? One obvious possibility is increased regulation. The Affordable Care Act for hospitals and Dodd-Frank for finance both passed in 2010, the year real wages began to decline. It might be a coincidence that the industries most affected by these two laws suffered the most damage. But the following facts lend some credence to regulation as a causal factor.

First, the decline in the share of workers in financial activities from 2006-10 was about one-fifth as rapid as that between 2010 and 2014. Given that the financial crisis peaked in autumn 2008, one would have expected the earlier period to see the most rapid declines, not the reverse.

Second, the share of workers in hospitals increased rapidly from 2006 to 2010, placing it among the top 10% of industries in labor growth. That trend was reversed in the past four years. Nursing and residential care's share of employment also grew in the early

period and declined in the latter one. Ambulatory health-care services, whose share did continue to grow from 2010 to 2014, slowed to one-fourth the pace of growth that prevailed from 2006 to 2010.

Third, industries with educationally similar workforces to those in finance and hospitals, like professional and technical services, enjoyed continued growth in their share of the workforce during the latter period. Even the construction industry, which was at the center of the recession and saw substantial declines between 2006 and 2010, experienced slight increases in share between 2010 and 2014.

Still, wage declines did not occur merely or even mostly because of movements out of hospitals and finance to lower-paying jobs. Even without the changes, the economy would have witnessed about three-fourths of a percentage point decline in wages from 2010 to 2014. Wages tend to move with productivity—and tax hikes on capital, threatened or actual, were not helpful to business investment, which spurs growth in labor productivity. Higher taxation of dividends and capital gains, as has occurred under President Obama, reduces incentive to invest and makes it more difficult to attract capital to the U.S. The president called for even more such increases in last week's State of the Union address.

The labor market has improved in recent months, with employment rising at a decent pace and unemployment continuing to fall. But the good news is tempered by the changing mix of jobs. Evidence supports the view that stagnant wages are a result of government policy.

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