



Labor of



Income paid to workers falls while corporate profits surge

Tracy Martin has an avid fan base. It's not uncommon for the 36-year-old woman to be approached in public, or even be hugged out of awe and adoration.

"Miss Tracy! Miss Tracy!" the little voices shout.

It's inevitable after so many years of working with children.

"That's all I've ever done," says Martin, who worked at a daycare center first while attending college and, years later, opened her own in-home facility. Now she teaches pre-kindergarten full-time at the Blue Springs, Mo., YMCA. "I just love it. Not one day have I ever said, 'I don't want to go to work.'"

Martin, a wife and mother to six, didn't choose her profession with monetary rewards in mind, although she says it does seem unfair

that educators or public servants, like police officers and firefighters, are paid less than those in the corporate world or Hollywood. Most workers' wages have not changed significantly during the past decade. Meanwhile, others have reaped large financial rewards.

The chief executives of the country's 500 biggest companies earned average paychecks (including salary, bonuses and other compensation such as exercised stock options) of \$10.9 million last year, according to Forbes.com, up from a \$1.9 million average CEO paycheck just a decade or so earlier.

And in the celebrity world, entertainers of all types also saw high earnings last year—Tom Cruise raked in \$67 million and even Paris Hilton collected \$7 million. The combined net worth of the nation's wealthiest was \$1.25 trillion, which is an increase of \$120 billion

from the year prior, according to Forbes.com.

The United States has experienced strong growth in average labor productivity since the mid-1990s, but income growth has not been equal across households, say Jonathan Willis, a senior economist, and Julie Wroblewski, a research associate, both with the Federal Reserve Bank of Kansas City.

“There has been little increase in real wages for low-income workers while executive pay has skyrocketed,” Wroblewski says. “There is growing public sentiment that the average household is not sharing in the recent economic prosperity.”

Willis and Wroblewski recently examined

This has contributed to strong economic growth. Economic theory suggests changes in productivity should affect compensation for labor and physical capital—the two main inputs to production. When more output is produced by a given amount of labor and capital, workers and those who own the capital get paid more.

During the past 30 years, the share of income paid to labor and owners of capital has remained stable on average. This shows the share of income received as labor compensation had not changed during the recent period of high productivity growth. However, income shares fluctuated in the short term, which likely is associated with the business cycle.

“ **Low-income households have seen no increase in real income during the past decade.** ”

how economic gains have been distributed during periods of high and low productivity growth. They found the share of income paid to labor has generally been constant. Short-term changes in the labor share have occurred, and these changes appear to be closely related to movements in the business cycle.

While the share of income paid to labor has been constant on average, income growth across households hasn't been equal. During the last decade of high productivity growth, only the top 10 percent of income earners, at most, appeared to experience real income growth equal to or greater than average labor productivity growth.

“Low-income households have seen no increase in real income during the past decade,” Willis says. “Most of the gains likely were concentrated in the top 1 percent of earners.”

Working harder

Between 1996 and 2006, labor productivity grew at a 2.8 percent rate, compared to 1.4 percent between 1974 and 1995.

U.S. Census data show income growth has differed substantially across households, which are divided into five quintiles based on income.

For the low productivity growth period between 1974 and 1995:

- The three lowest quintiles had average annual rates for real income growth of 0.4 percent or less, while the average labor productivity growth rate was 1.4 percent.
- Only the top quintile of households experienced real income growth equal to the labor productivity growth rate. The top 5 percent of all households experienced the strongest income growth of 1.9 percent per year.

From 1996 to 2006, it's difficult to identify any household quintile that received strong increases in income growth rates, whereas average labor productivity growth doubled:

- The bottom household quintile experienced no real income growth compared to the prior period.
- Households in the second, third and fourth quintiles experienced only a small increase from the prior period.

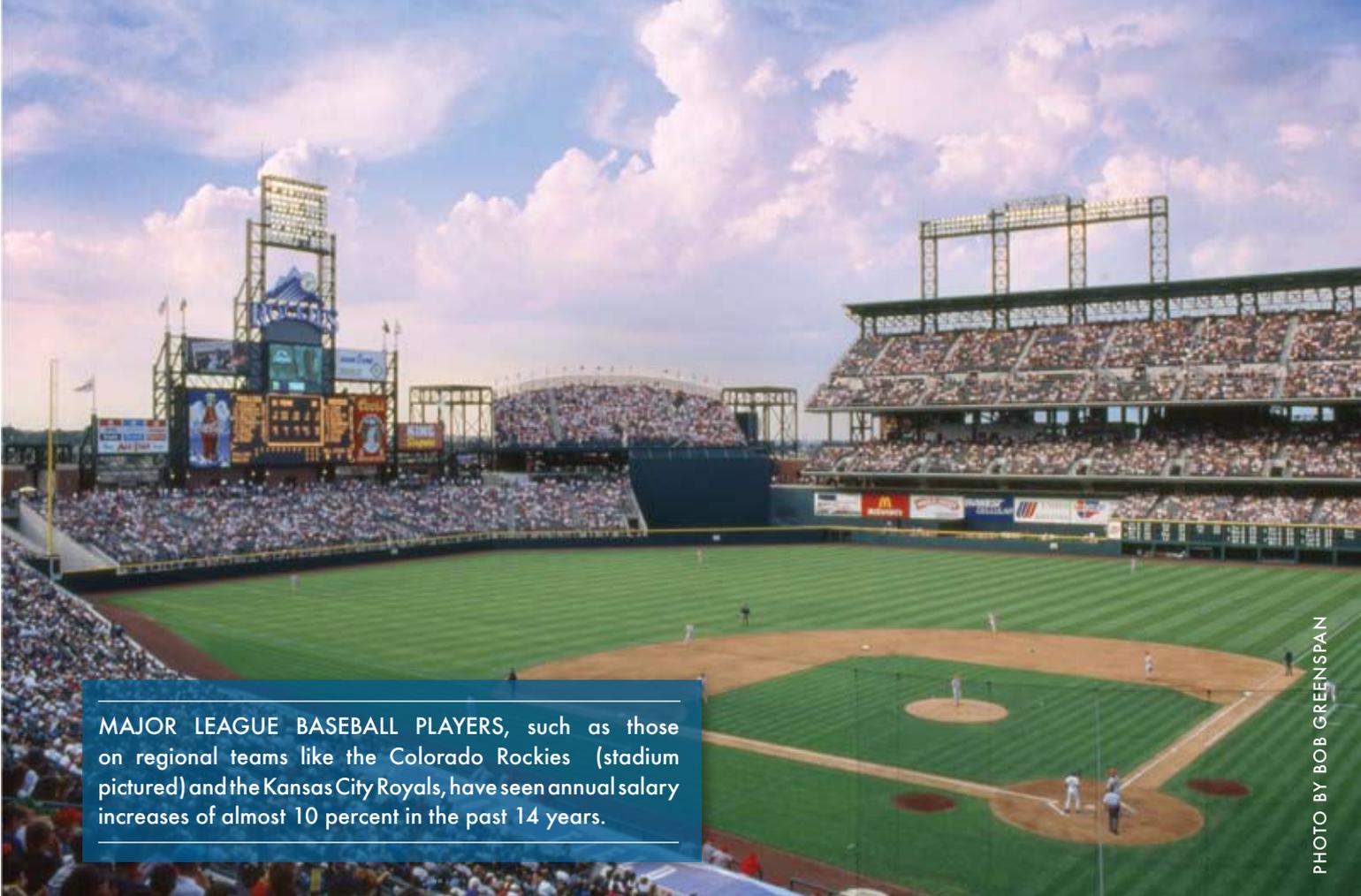


PHOTO BY BOB GREENSPAN

MAJOR LEAGUE BASEBALL PLAYERS, such as those on regional teams like the Colorado Rockies (stadium pictured) and the Kansas City Royals, have seen annual salary increases of almost 10 percent in the past 14 years.

- For the top quintile, income growth was unchanged. The top 5 percent of households actually experienced a slight decline in annual income growth from 1.9 percent to 1.6 percent.

“This evidence is in line with recent comments from observers suggesting a large segment of households are not benefiting significantly from recent economic prosperity,” Wroblewski says. “Few households received increases in income reflecting the sharp rise in productivity.”

There are several possibilities that may explain where gains from the past decade went, say Willis and Wroblewski. One possibility is measurement issues have masked the size of income growth at the top of the household distribution. An alternative dataset from the IRS reveals the highest incomes are not fully reported in the Census survey, which only records income sources up to \$1 million.

This means the reported income of high salary earners, such as Yahoo! CEO Terry Semel (who made \$231 million last year), is capped and any income growth for these individuals won't be captured in the data.

Based on this alternative dataset from the IRS, only the top 10 percent, at most, of the income distribution received salary income growth equal to or greater than the rate of average labor productivity growth from 1997 to 2001. The top 1 percent received nearly one-fourth of the increase in total wages and salaries.

Payday

This season, the Kansas City Royals signed Gil Meche to a five-year, \$55 million contract—an eye-popping salary for a pitcher who has never won more than 15 games in a season. Royals General Manager Dayton Moore offered the 28-year-old former Seattle Mariner

the deal in hopes that Meche's potential would blossom, transforming the struggling team into a winning one.

Hooking sports figures at high prices has become the norm. Between 1987 and 2001, major league baseball players' salaries grew 8.9 percent annually. Entertainers and professional athletes account for about 12 percent of income earned by those at the top of the income distribution.

Also related to the entertainment industry are the technological advancements of the past 10 years. Top professionals in the entertainment industry have been able to reach wider audiences, therefore earning higher incomes as a result of new innovations, such as CDs, DVDs, cable TV, the Internet, video games and iPods. Video game software creators' salaries grew at a rate of 6 percentage points higher than workers who created non-entertainment software.

While multimillion-dollar paychecks handed out in the entertainment industry may seem highly prevalent in today's wealthy society, Willis says a more likely explanation for the strong income growth at the top of the income distribution is the rapid acceleration of CEO compensation. The ratio of CEO compensation, including exercised stock options, to average worker compensation increased from 100 to 185 from 1995 to 2003.

One empirical study of 1,500 large public firms concluded executive compensation from 1993 to 2003 increased by 76

percent more than can be explained by factors tied to the firms' performance. CEOs in the United States earned three times as much on average as CEOs in 13 other advanced countries.

"This strongly implies increased compensation for CEOs in this country is due primarily to factors unrelated to productivity," Willis says.

Factors unrelated to productivity have also affected income distribution: The federal minimum wage hasn't changed in 10 years, which is a decline in real terms as a result of inflation; the decline of labor unions likely contributed to slower income growth; and the number of immigrants has grown rapidly, adding a large supply of low-skilled workers to the labor market.

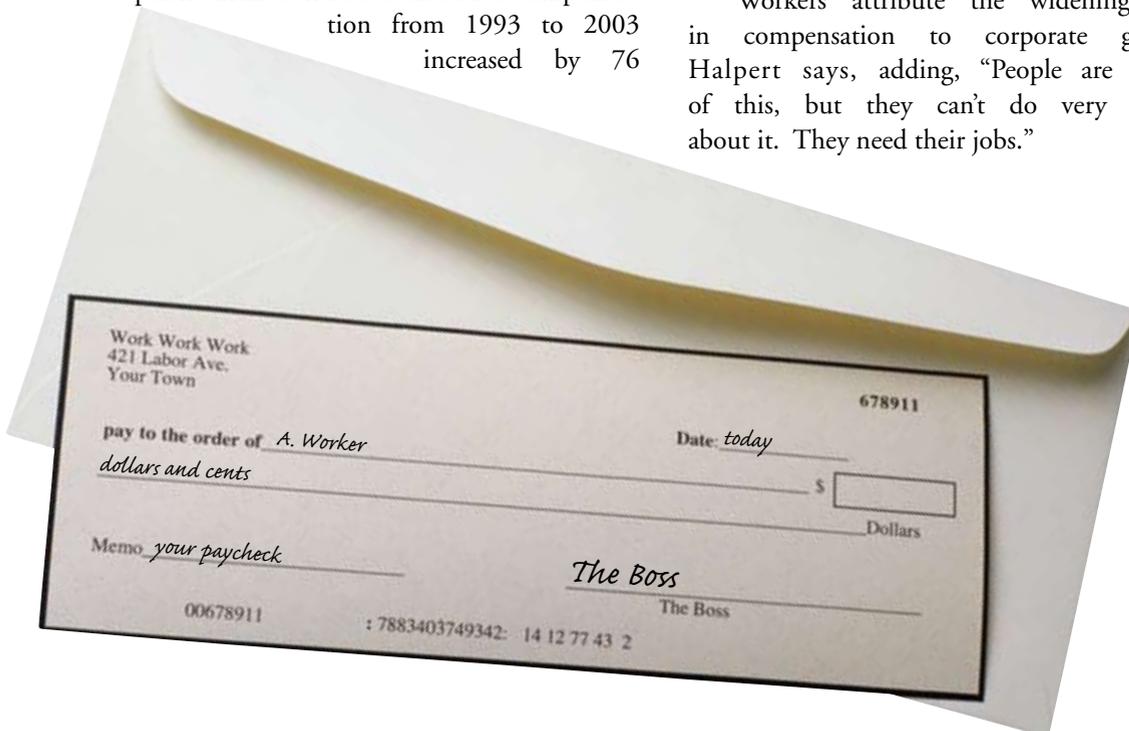
Impact

The working population recognizes it's working harder and longer, but not reaping monetary benefits, say Burton Halpert, associate professor of sociology, and Matthew Forstater, associate professor of economics, both at the University of Missouri-Kansas City.

"I feel very sad for the average family out there," Halpert says. "They're working hard and not seeing much gain."

Forstater says, "They're experiencing it—they're struggling with their mortgage; they're struggling with their credit cards."

Workers attribute the widening gap in compensation to corporate greed, Halpert says, adding, "People are aware of this, but they can't do very much about it. They need their jobs."





TRACY MARTIN LEADS HER PRE-KINDERGARTEN CLASS at the Blue Springs, Mo., YMCA in the hokey pokey song and dance. Martin has worked there for eight years and in child care all of her adult life.

This lowers morale, and, over time, productivity will suffer, Forstater and Halpert predict. Because incentives prompt workers, discontent will lead to unmotivated employees, causing a slowdown which results in less profitability.

“You need a committed population (of workers) out there,” Halpert says. “And why should people be committed if they aren’t getting a fair shake?”

Tracy Martin knows there are powerful CEOs, superstar athletes and glamorous celebrities who make more—millions more—in one year than she ever will in her lifetime. But, that doesn’t bother her.

“Why would I go to a job that I don’t enjoy

every day but make a lot of money?” Martin says. “I’ll stay where I am.”

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BY BRYE STEEVES, SENIOR WRITER

FURTHER RESOURCES

WHAT HAPPENED TO THE GAINS FROM STRONG PRODUCTIVITY GROWTH?

By Jonathan L. Willis and Julie Wroblewski
www.KansasCityFed.org/TEN

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