

America's Wage Problem

Why are we surprised that fewer people want to work?

BY PHILIP K. VERLEGER, JR.

The Federal Reserve has taken great interest in the very slow growth of employment and labor force participation. It emerged first in an August 11 speech in Sweden by Fed Vice Chairman Stanley Fischer. Chair Janet Yellen then hammered the point home in her talk at the Kansas City Fed's annual Jackson Hole symposium. In case anyone missed the central bank's concern, the symposium title was "Re-Evaluating Labor Market Dynamics." The presentations comprehensively reviewed the literature and current thinking. However, one subject escaped attention: the growing monopsony power of employers—a monopsony being a market where the purchaser of goods and services can dictate terms since one buyer faces many sellers. The failure to recognize and address this structural change may restrain the nation's economic growth for a decade or more by limiting growth in per capita income and the number of individuals seeking employment.

In his remarks, Fischer noted that the diminishing labor supply was contributing to the United States' slow recovery. He commented that "the surprising weakness in labor participation reflects still poor cyclical conditions." Noting that some workers who have dropped out may be discouraged, he voiced the hope that "further strengthening of the economy will likely pull some of these workers back into the labor market."

In Jackson Hole, Yellen addressed the subject in far greater detail during her opening speech at the symposium. An economist who

Philip K. Verleger, Jr., is president of PKVerleger LLC.

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220 I Street, N.E., Suite 200

Washington, D.C. 20002

Phone: 202-861-0791

Fax: 202-861-0790

www.international-economy.com
editor@international-economy.com

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studied labor issues in the past, she provided a thorough, compact review of the slow growth in employment. She began by hypothesizing that the market had been “polarized,” meaning the “relative number of middle-skill jobs” had dropped. Yellen suggested that the declining participation rate could also relate to baby boomers getting older, disability increasing, and people returning to school, among other reasons.

As she concluded her talk, Yellen focused on labor compensation. Noting the absence of any real wage increase, she suggested the recovery in labor markets may have been overstated. “And, since wage movements have historically been sensitive to tightness in the labor market, the recent behavior of both nominal and real wages point to weaker labor market conditions than would be indicated by the current unemployment rate.” This last remark has been interpreted to mean the Federal Reserve may further delay monetary tightening.

The continued focus on the rate of change in employment and wages, following the long tradition of macroeconomics and central banking, misses a new development in labor markets: the growth in employer market power. This development was highlighted by Neil Irwin in the *New York Times*, published at nearly the same time Fischer was speaking, titled “Where Have All the Truckers Gone?”

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Irwin explains that Swift Transportation, one of the nation’s largest trucking companies, shocked equity markets in July when its earnings fell short of expectations. Irwin observes that the earnings shortfall stemmed not from a lack of business but a lack of drivers. In a letter to shareholders, Swift’s management said, “Our driver turnover and unseated truck count were higher than anticipated.” In other words, Swift had to park trucks because it could not find enough drivers.

The driver shortage has not occurred because of the technical difficulty of driving a truck. Drivers can be trained in as little as six weeks. The problem is few individuals are willing to take the job for the wage being offered. In words every central banker should take to heart, Irwin writes,

Corporate America has become so parsimonious about paying workers outside the executive suite that meaningful wage increases may seem an unacceptable affront. In this environment, it may be easier to say “There is a shortage of skilled workers,” than “We aren’t paying our workers enough,” even if, in economic terms, those come down to the same thing.

The shortage of long-haul truck drivers has arisen in part due to changes in government regulations that reduced the monthly mile limit for drivers. Truck operators get paid by the mile. As Irwin notes, the average driver is restricted to eight thousand miles in a month today, down from eleven thousand in 2007. The loss translates to a wage reduction of 27 percent because trucking companies did not change compensation initially. I know one driver with thirty years of experience and no accidents

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who retired when the regulations changed. I am not surprised.

Trucking is not the only industry where monopsony prevails. Regional airlines have complained of a pilot shortage. The grumbles became louder when new regulations further limited pilot duty time. Republic Airlines, for example, cut its fleet by twenty-seven jets and lowered its earnings forecast because it could not find enough qualified pilots. The regional carriers, who provide much of the short-haul service for the large trunk airlines such as United, blame regulations for the shortfall.

The Government Accountability Office has examined the employment issue in depth, concluding that no pilot shortage existed. Instead, paraphrasing the study, the agency found a shortage of qualified individuals willing to accept the starting salaries offered by the regional carriers.

Confronted with such a situation, the logical solution is to offer employees more money. Swift could find more drivers if it boosted pay. Republic Airlines could find more pilots if it raised salaries. So why don't these companies act? The answer lies in one word: monopsony.

A large share of Swift's customers, as well as those of other motor carriers, are companies such as Walmart. These firms enjoy significant monopsony power and are notorious for exercising it. As Irwin noted, "Trucking companies themselves are typically working on thin price margins and serving customers on long-term

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contracts, which means that if they simply raised pay sharply to recruit more truckers, they could end up losing money."

Republic Airlines faces a similar constraint. Republic operates flights for American, Delta, and United Airlines. Republic's customers pay the company per flight under longer-term contracts. A decision by Republic to raise wages absent an agreement with one of its customers would cause it to lose money. Thus instead of raising salaries, Republic sells off planes and cancels flights. Ever wonder why seating is getting so tight?

This situation permeates the economy. In 2012, machinists working for Caterpillar were forced to

accept a wage freeze and sacrifice benefits. Workers in the auto industry, the airline industry, and many other sectors have been forced to do the same. Managers have market power and have used it to drive down wages.

These actions have several costs. First, the number of people seeking work has declined, at least officially.

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No doubt some are working in the cash economy while others have managed to retire or qualify for disability payments. We teach in economics that supply declines when prices go down. Why are we surprised that fewer people want to work?

The decrease in the labor force cuts U.S. GDP, since GDP can be characterized as the product of output per capita multiplied by the number of people working. The unwillingness of many Americans to work for low wages reduces GDP. Employer exercise of monopsony power also depresses consumption. Yellen and Irwin both noted that wage income now accounts for the lowest share of GDP since 1947, while the profit share is at a postwar high. Not surprisingly, growth is stunted because it is wage earners who drive consumption.

My conclusion is that employer exercise of monopsony power over suppliers and over labor explains much of the labor market misery noted by Yellen and Fischer. Interestingly, the Bundesbank seems to have come to the same conclusion. Reuters reported at the end of July that the organization's chief economist was pushing labor unions to be more aggressive. As one commentator explained, "Better-paid workers in the region's biggest economy could be part of the solution [to Europe's problems] if they use their extra income to buy goods from other euro-area countries."

Perhaps U.S. firms and employers should take the Bundesbank's advice. Perhaps increased payments to suppliers passed on to employees might help accelerate U.S. growth.

U.S. central bankers should certainly emulate the Bundesbank and encourage employers to be more flexible. If they adopt this strategy, they might find that workers not now looking for jobs may just get interested in employment again. ◆