

WAGE GAINS IN THE U.S. AND ITS METRO AREA ECONOMIES

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INTRODUCTION

Global Insight and the US Conference of Mayors have documented the conditions of the U.S. workforce and of its metro economies since the depths of the 2001 recession. In November 2003 we jointly released a report, "Types of Jobs Lost and Gained 2001-2005". At that time, we pointed out that though U.S. employment would recoup all of the 2.4 million jobs lost in the recession by 2004, a wage gap of almost 18% would develop between jobs lost and jobs gained in the current business cycle. In addition, job gains were not expected to return in the same sectors as where they were lost. High-paying manufacturing and information activities jobs were lost, to be replaced by lower paying positions in administration and support and accommodation and food services.

In June 2004, our report "Types of Jobs Lost 2000–2006" further analyzed the wage gap trend in health insurance benefits associated with the changing sectoral composition of employment. We found a 'benefits gap' of 14.5%.

Most recently, in January 2006, in "The Role of Metro Areas in the U.S. Economy" we concluded that the measured wage gap, given the composition of actual job gains in 2004 and 2005, is substantially higher than our earlier projection. The average wage, measured in 2003, of those added jobs in the leading expanding sectors has been just \$34,378, 4.1% lower than anticipated in the recovery. The wage gap between jobs lost and jobs gained is, in fact, 21%.

In this report we examine the impact that this wage gap has had on income gains throughout the economy. With the close of 2005, we can now examine the condition of the U.S. workforce following the cyclical dynamics of the first half of the decade. We have focused on wage gains from the vantage of household budgets in the U.S. and its 361 metro areas. From this perspective we can put into context the stress placed on consumer spending by the recent dramatic increases in the price of oil and gasoline.

WAGE GAINS 2000 - 2005

Employment gains in 2005 were robust, at over 2 million new jobs, and growth of 1.5%—the greatest since 2000. The average job in 2005 earned a salary of \$43,500, a 4.6% increase over 2004. This was the second consecutive year of annual gains in excess of 4%. Since 2000, wage gains have averaged a compound annual rate of increase of 3.3%, although from 2001 through 2003 average annual wage gains were less than 3%.

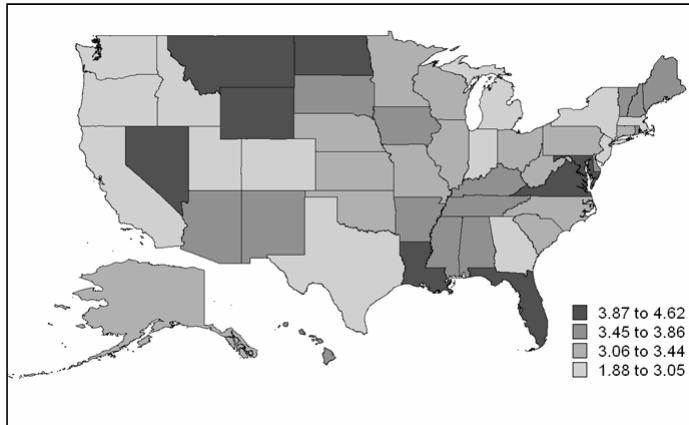
In real terms, adjusted for inflation, wage gains in both 2004 and 2005 were 1.7%. This represented a significant acceleration over 2001-2003, when the total real wage gain was just 1.7% over the entire three years. In the last decade, 1990-2000, compound annual wage growth was also 1.7%, though the second half of the decade achieved a yearly rate of 2.8%.

Notable during this decade has been the declining share of national income represented by wages. Wages as a percent of national income have declined from 57.3% in 2000 to 55.9% in 2005. Meanwhile, real gross domestic product (GDP), which measures the value of worker output, grew 2.6% annually over 2000 to 2005. One might expect that the increase

in wages would be roughly equal to the value of output, but real GDP per worker grew by 2.3%, more than double the annual real wage gains of 1.0%. If wages had grown at the same rate as GDP per worker, the average wage would be 7.8% higher, or \$46,800.

Table 1 in the Appendix displays growth in real wages in our 361 largest metro areas from 2000-2005. It also ranks metro performance by real wage growth in 2004-05. Here we can see that the strongest gains in real wages are again largely concentrated in the Southeast and Gulf Coast states. Indeed, there are seven Florida metros in the top twenty alone, a result of that state's vibrant economic and population growth.

Compound Growth in Wages 2000-2005



On a regional basis, the South led all regions with a 1.5% annual real wage gain during the first half of the decade, while the Northeast, Midwest, and Pacific regions achieved gains of less than 1%. The state distribution is illustrated in the map above and Table 2 in the Appendix. By industry, professional and business services and finance gained the most over this period, at a 1.7% annual rate. Manufacturing, and trade, transportation, and utilities gained just 0.6% per year.

The sluggish pace of wage gains early in this decade is the result of a number of factors. The 2001 recession and the resulting layoffs and decline in labor demand had a very large impact. During a business downturn, the bargaining power of labor, unionized or not, is reduced. This has happened in all previous U.S. business cycles. What has been surprising in the current cycle is the sluggish response of wages even as business conditions improved, hiring resumed, and unemployment declined. Recent data in 2006 does point to resumed wage growth at last.

The other notable contributing factor this decade has been the rapid pace of globalization, exemplified by outsourcing and off-shoring, which increases the degree to which the American worker is in competition with lower-paid labor around the globe. In addition, as we have documented in our work on the wage gap, structural change among expanding and contracting industries has worked to labor's disadvantage.

THE DISTRIBUTION OF WAGE GAINS 2000 – 2005: A LOOK AT INCOME

The analysis thus far has highlighted the relative position of workers as a group in garnering a share of U.S. productivity and income. However, the average wage per job can obscure

changes in the distribution of wages across workers. Indeed, the wage gains realized thus far this decade have accumulated in a visibly unequal pattern. As documented most extensively by the Economic Policy Institute with data from the Bureau of the Census' Current Population Survey, real median incomes fell from 2000 to 2004, the year of the most recent survey.¹ And income gains were garnered disproportionately by the highest income earners. In 2004, for instance, the real average income of the top 5% of the income distribution increased by 1.7%, while the four lowest quintiles (the bottom 80% of the distribution) suffered losses. The incomes of the lowest 20% declined slightly (-0.0%), the second quintile lost 0.5%, the middle quintile 0.7%, and the fourth 1.1%.

THE ECONOMIC OUTLOOK FOR 2006

The U.S. economy picked up a solid head of steam in the first quarter of 2006. At 4.8%, first-quarter GDP growth showed the anticipated rebound from the fourth-quarter weakness, as consumer spending surged by 5.5%, while business fixed investment and exports advanced strongly. Most recent indicators have looked solid, including the latest ISM surveys and chain store reports, despite the run-up in gasoline prices. The April labor market report was a disappointment, though, showing only 138,000 jobs created, a possible early sign of a slowdown—but the report was not as weak as it seemed on the surface, since wages rose faster and the workweek lengthened.

In April, hourly earnings of non-supervisory workers rose a sharp 0.5%, taking its year-on-year increase up to 3.8%, the strongest since August 2001. The chart below indicates the growth in hourly earnings, and demonstrates that earnings are now growing almost as strongly as they were pre-recession. This suggests a tightening labor market, with a risk that higher wage increases will create price inflation. Total hours worked were also up sharply, by 0.5%. A longer workweek is not a sign of a softening labor market. Combining rising wages with longer hours suggests a sharp increase in overall wage incomes in April, providing important support for consumer spending as households face higher gasoline prices.

Average Hourly Earnings

(Percent change from a year earlier)



The surge in oil and gasoline prices in recent weeks has emphasized how the tight global oil market is vulnerable to any bad news on supply prospects (Iran and Nigeria are the key ar-

¹ Economic Policy Institute, "Income Picture", August 2005, http://www.epinet.org/content.cfm/webfeatures_econindicators_income20050831.

eas of concern right now). Our new assumption is that oil prices will remain close to \$70/barrel through the summer months, before edging back down to average just more than \$65 in 2007. This is \$6-7 above our April assumptions. The effects of oil market tightness have been exacerbated by fears of gasoline supply shortfalls. We expect gasoline prices to remain close to \$3/gallon through the summer months, but then to ease back towards \$2.50 by the end of the year. We estimate that the rise in gasoline prices from \$2.44 in March to almost \$3.00 as of early May has absorbed about 0.7% of consumers' disposable income. We would expect consumers to pull back on spending on other items during May and June, as they adjust to the gasoline burden, and have shaded our second- and third-quarter consumer spending projections down from an average of 3.2% growth to an average of 2.8%.

Global Insight forecasts that wage gains in 2006 will be 3.6% (1.3% in real terms), and in 2007 will be 3.3% (a 1.7% real rate). But a 50% gas price increase (as in from \$2 to \$3) would displace 46% of projected wage gains for 2006.

GASOLINE PRICES AND HOUSEHOLD BUDGETS

U.S. households spend a sizable portion of their budgets on energy. In 2005, U.S. households spent \$287 billion on gasoline and oil for automobiles and trucks. Expenditures for energy for other household uses (heating, cooling, and electricity) totaled an additional \$225 billion. While households can and do take certain actions to decrease their use of energy of all types, much of this spending is unavoidable, constituting a necessity rather than a discretionary purchase. Thus, as energy prices escalate, the greater spending devoted to energy limits the discretionary income of the household, and forces a reduction in other spending.

We saw this clearly in 2005, when energy expenditures increased sharply, as gasoline and oil expenditures increased by 25%, fuel oil by 20%, utility natural gas by 25%, and electricity by 10%. Energy expenditures in 2005 represented 5.9% of consumer spending, a 20.3% increase over 2004. This 20.3% increase represented 1.0% of all household spending, and hence decreased other discretionary income and spending by that amount. In 2006, we project that energy expenditures will increase by an additional 7.5%, eating further into discretionary income. Spending on gasoline alone will top \$300 billion, more than double that of five years ago.

This run-up in energy costs has taken a big bite out of earnings. As a fraction of all wage and salary disbursements in 2005, energy expenditures equaled 9.0%, an increase of 1.5% over 2004. Earnings themselves increased in 2005 by an average of 4.6%. Thus increased energy expenditures wiped out almost one third of last year's earnings gain. The increased cost of gasoline alone averaged 17% of the wage gain. The impact on spending is clear: as households stretch their budgets to cover higher energy costs, they have fewer dollars left for discretionary purchases.

Table 3 contrasts, for 116 metro areas, the estimated increase in the annual wage in 2005 with an estimate of the increased cost of commuting in those metros due to a \$1.00 higher per gallon price of gasoline.² In the third column we calculate the fraction of that wage in-

² Calculations based on data from the American Community Survey and from the Federal Highway Administration.

crease that is lost due to higher gas prices. Scranton-Wilkes Barre, PA is the median metro in that case. The annual increased cost of fuel for commuting of \$412 there is 33% of the average workers 2005 salary increase of \$1,260. But commuting patterns vary widely across metros. The worst hit by fuel costs relative to wage gains is Spokane, Washington, where 78% of weak wage gains are wiped out by higher gas costs.

Of course, for those workers who are not sharing in wage gains, and we have seen that for much of this decade most did not, the increase fuel prices directly results in decreased disposable income.

WAGE GAINS ACROSS METROPOLITAN AREAS

Table 4 indicates the average wage in nominal terms for all 361 metro areas in 2005, as well as the annual rate of wage gain this decade. The U.S. average of 3.3% was topped by 180 metros. Seven metros averaged 5% gains per year, and 72 exceed 4%. Only Salt Lake City metro wages declined since 2000, when they were in the midst of the boom of preparation for the Winter Olympics. But 21 other metros had wage gains of less than 2% per year, and 17 additional metros had gains which were less than the rate of inflation. Large metros included in this group were those, like San Jose, which scaled the high-tech peaks, such as San Francisco, Boise, and Austin. But the Midwest, notably Detroit, places the greatest number in the bottom ranks. Hinesville-Fort Stewart, Georgia topped the wage gain ranks for the first half-decade, with 6% annual growth. San Diego was the largest metro among the six others which average gains of at least 5% per year.

Estimated average wage levels for 2005 across 361 metros range from \$76,500 in San Jose-Sunnyvale-Santa Clara, CA to \$26,800 in Logan, UT-ID. Twelve metros have annual wage levels in excess of \$50,000, among them only Boulder, Colorado is outside California and the Northeast. Meanwhile, twenty metros had 2005 average wages which fell short of \$30,000.

In 2006, we expect the strongest wage growth to be concentrated in rebounding economies (see Table 5). California, for example, has lagged its neighbors in terms of economic growth since the recession. In 2006, we expect a broad-based recovery in higher-paying industries to help drive up wages. Similarly, the Louisiana metros are rebounding from the devastating effects of Hurricane Katrina, and the need for workers will put upward pressure on wages. At the other end of the spectrum are metro areas where economic growth is both weak and largely concentrated in the low-paying services industries. South Carolina, for example, has been experiencing the rapid loss of high-paying manufacturing jobs. At the same time, employment gains have been concentrated in low wage sectors such as leisure and hospitality, thus wage growth remains weak.

CONCLUSION

In past research we have reported that the labor market, after a protracted period of stagnation, had finally begun to generate significant numbers of new jobs across a broad spectrum of metro areas. In this report we have documented the similar stagnation of wage levels in the first half of the decade. In 2004 and 2005 wage gains have at last matched those of previous economic expansions. However, the distribution of such gains is skewed

toward high income workers, and has not fully benefited all groups. Moreover, those lagging behind in income gains are now caught in a further budget squeeze as elevated energy prices dissipate a large chunk of their apparent gain in disposable income.