RAMBLER INVESTMENT FUND

More Power to the American Working Class

By Trevor Tormoen

As the stock market continues to reach new highs and the gap between America's richest and poorest continues to grow, an ever-brightening spotlight shines on wage growth in the U.S., or lack thereof. Since 1973, real wage increases have decoupled from productivity measures; productivity has grown by 138.7% while real wages have only increased by 9% over the same period, suggesting that workers have not been fairly compensated for their aggregate output. In an attempt to remedy this issue, select politicians and activists have argued for workers to be granted more power and influence in our modern economy in a variety of ways, including raising the minimum wage. Indeed, this measure would help close this gap, but there are more factors at play that have contributed to this phenomenon. In order to move toward fully closing this gap, stronger competition among businesses and raising the federal minimum wage must take place.

One primary influence creating the depression of real wages within the American economy is the increase in monopsony power, or a firm's ability to hold down wages due to a lack of competition. In a competitive labor market, workers have the ability to seek higher-paying employment elsewhere if they consider their work undervalued by their employers. However, if there is insufficient competition within the market to provide these new opportunities, workers are stuck with their current depressed wage. An investigation conducted by the National Bureau of Economic Research points to this same culprit as a leading factor in wage stagnation. The study was conducted using county-level wage and productivity data from 300,000 manufacturing plants over the past four decades obtained from the U.S. Census Bureau. Additionally, the researchers measured this observed data against the Herfindahl Hirschman Index (HHI), a measure that can quantify labor-market concentration, or the number of companies offering work within the same industry in a certain geographical area on a scale of 1 to 0, a higher number indicating a low concentration of employers. Unsurprisingly, the study was able to clearly demonstrate a connection between labor-market concentration, monopsony power, and decreasing wages; there was a strong negative correlation between

HHI and wages for a given geographical area. Further, their research discovered that firms have historically used monopsony power to suppress wages even when productivity and profitability has been strong. Perhaps most concerningly, the closer to the present the data became, the more prominent the effect, suggesting the phenomenon is getting worse. According to Efraim Benmelech, the lead researcher in the study and the Harold L. Stuart Professor of Finance at Northwestern University, "[i]t probably explains at least 30 percent of the fact that wages have not been increasing". Although he does not claim the have the single concrete explanation, the prevalence of monopsony power caused by low local labor-market concentrations seems to be a primary explanation for wage stagnation. Unfortunately, there is not a sole policy implementation that can fix a lack of employer competition in the labor market other than enforcing preexisting antitrust laws or writing new ones, making finding a solution to this issue an arduous task.

In a similar vein, a second explanation for the stagnant growth of real wages is an increase in business markups as a result of lower competition between firms. Throughout the most recent decades, the U.S. economy has experienced higher levels of market concentration. As preexisting firms continue to grow in market share and reach economies of scale, they stifle competition by preventing new firms from reaching maturity by either pricing them out of the market or through acquisition. As this trend continues, an ever-decreasing number of firms compete for the same number of customers, granting each company more market pricing power. Once granted the ability to increase their prices, firms will do so through raising their markup, or the difference between production costs and the asking price of the product. According to macroeconomic theory, business income can be distributed between two entities within the organization: labor and capital. Historically speaking, as markups increase, labor's share of income decreases, granting workers a smaller fraction of newly earned business income. According to a study conducted by researchers at Lunt University, since the early 1980s, average markups have increased by as much as 7-12% and labor's share of income has fallen in turn. The inability for workers to readily receive raises within their firm, compounded by a lack of extra-organizational jobs available due to increases in monopsony power, severely depresses the ability for wages to grow. As this phenomenon is taking place at an economy-wide level, the solution is the same as the suggestion for the rise in monopsony power: increased competition between businesses within a given market.

A third factor influencing low wage growth in the U.S. is mismanagement of the federal minimum wage by Congress. The United States is one of the only developed nations that places the management of the nation's minimum wage in the hands of its legislative body; most nations, such as the United Kingdom and France, have a dedicated committee comprised of economists and labor specialists that adjust the figure for changes in inflation and costs of living. Since the revision is made at the end of every year, these nations maintain a minimum wage that more closely matches the ever-changing needs of their citizenry. Additionally, however noble, the call for an immediate dramatic increase in the federal minimum wage to $15 could cause more harm than good; a sudden massive rise in labor costs to business that pay their workers the minimum wage could be devastating, especially during times of economic recession. Instead, a gradual increase should be implemented to allow businesses to slowly adjust to the newfound labor costs without dramatically raising prices or laying off workers. Indeed, many states have already increased their minimum wages to more sustainable levels, but there exist 21 states that abide by the federal standard. Further, almost every state that has decided to increase its minimum wage has done so on an incremental basis over a certain period to time to allow companies to adapt to the newly added costs. To help America's low earning workers, the U.S. Congress should pass legislation incrementally increasing the minimum wage to $15 over a set period of time. Then, once this figure is achieved, the burden should be transferred to an independent, bipartisan organization to ensure the effective management of national minimum wage in the future.

Real wages in the U.S. economy have severely lagged behind developments in productivity as a result of a lack of sufficient competition between businesses and a stagnant minimum wage. However, these explanations to not paint a complete picture; the expansion of the gig economy, the prevalence of cheap labor overseas, and the increase in the compensation of business executives all contribute to the suppression of American wages. Unfortunately, there is not a single, distinct remedy for this issue. However, if pro-competition measures and increases in the minimum wage are implemented at the federal level by our newly-elected officials, American workers can begin to claw back the compensation they rightly deserve.