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ECONOMICS: US PERSPECTIVES

MAKING SENSE OF VARIOUS WAGE AND COMPENSATION GAUGES

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Fundamental shifts in compensation patterns make it difficult to discern underlying wage trends in a timely manner. Notably, more and more companies opt to use variable rewards instead of annual pay increases. The shift in pay patterns suggests that the widely followed monthly and quarterly measures of wages and compensation will miss the timing of wage gains—and may miss the scale of those increases as well.

The US Bureau of Labor Statistics (BLS) publishes several monthly and quarterly estimates of wage and compensation data. Although these wage gauges tend to move in unison over time, they don't capture identical information, nor do they all capture important cyclical shifts in broad wage and compensation trends.

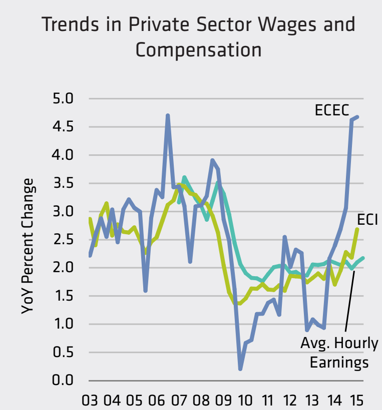
Monthly Earnings Report: Far from Exact

For example, the most widely used measure of wages is the average hourly earnings (AHE) series—included in the monthly report on payroll, or establishment, employment. The advantage of this wage gauge is its timeliness: average hourly earnings data for a month are reported on the first Friday of the following month. But it also has serious shortcomings.

First, this series is not a direct measure of wages. Government statisticians receive data on gross payrolls and gross hours, and then derive the AHE series. As a result, the earnings data represent the monies paid to an average worker for a certain pay period, which is different from an average wage rate. Second, the number of companies that provide gross pay and gross hours data is less than half the number that provide employment data. Third, the average hourly earnings data is weighted by the level of employment, so shifts in employment from high-wage to low-wage industries or vice versa could influence the monthly results (up or down). Fourth, the AHE series is limited to wages and salaries. That means it excludes employee benefits, irregular commissions and bonuses, and retroactive payments.

And these irregular forms of compensation have become increasingly more common. In fact, a recent study by Aon Hewitt, a global human resources company, found that variable compensation (i.e., short-term awards and irregular bonuses) were given to 12.7% of all workers last year. That translates to one in eight workers today, compared with one in 25 workers in the late 1980s, when they first started tracking this form of compensation. Given the absence of these variable forms of compensation from the AHE series, we would argue that this wage series is the least accurate of the regularly published gauges.

Display 1
Different Speed on Wages



Through June 30, 2015
Source: Bureau of Labor Statistics (BLS) and Haver Analytics

Quarterly Measures: More Comprehensive but Small Sampling Universe

Another widely followed measure of wages is the employment cost index (ECI), which is published on a quarterly basis. The advantage of the ECI is that it covers a wide range of pay schemes. For example, it includes traditional wage and salary data, production bonuses, incentive earnings, commission payments and cost-of-living adjustments. It also includes such items as insurance and retirement benefits as well as lump-sum payments that are often made instead of more traditional wage and salary increases. The ECI also controls for employment shifts in occupations and industries that might otherwise alter the compensation numbers up or down. The shortcoming of the ECI series is its small sample size—it represents only 8,600 establishments out of approximately 9.4 million businesses.

A lesser followed, but equally important, wage or compensation gauge is the employer cost for employee compensation (ECEC) series. Although it is based on the same sample as the ECI series, the ECEC differs in that it does not control for employment shifts between occupations and industries. And it appears that the recent outsized gain in the ECEC relative to the ECI is due to a relative shift in employment to the higher-paying occupations and industries (*Display 1, previous page*).

Changes in Pay Schemes and Data Measurement Issues

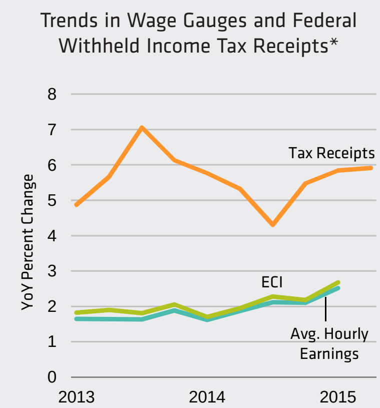
The ECI and ECEC are both trying to measure compensation costs for a specific period (i.e., the most recent quarter) instead of compensation paid for the past year or so. The problem that arises is that a number of companies have linked part of their workers' compensation to annual profits. Thus, the scale of what is paid to workers can vary significantly from year to year and, more importantly, the bonus is not paid out in the year that it was actually earned.

For example, Ford Motor Company's 50,000 hourly workers have the potential to receive a bonus in March based on what the company earned in the prior year. Other companies follow a similar scheme and changes are made periodically.

Interestingly, Delta Air Lines pilots recently voted down a new contract proposal that would have changed their bonus-profit scheme. The current plan calls for the company to pay workers a total of 10% of pretax income up to $2.5 billion, and 20% of any profits over that threshold. The new proposal would have changed the payout to 20% only on profits over $6 billion, and 10% payout below that profit threshold.

But we are not confident that these bonus-type payment schemes are being fully captured when we look at the methodology used to estimate the ECI and ECEC series. Nor would this be the first time the ECI and ECEC failed to fully account for the growth in labor compensation. In the late 1990s, stock-option pay schemes triggered a large flow of income to workers that was later captured in GDP-based income and compensation measures, but never in the ECI or ECEC series.

Display 2
Large Gap Between Wage Growth and Tax Receipts



*Smoothed 4-Quarter Year-over-Year Percent Change Based on 4-Quarter Moving Sum
Through June 30, 2015
Source: BLS, Haver Analytics and US Department of the Treasury

What Data Are Both Timely and Telling?

We continue to rely on federal tax data as a gauge of income and total compensation gains. The percentage increases in withheld income tax receipts over the past few years have been strong—in the high single-digit range (*Display 2. Note: the federal individual tax receipts do not include estimated tax payments and final settlements. If they did, the growth rate would have been approximately three percentage points higher over the past few years*).

These robust tax receipts tell us that compensation gains are running far above the 2.0%–2.5% numbers being reported in the AHE or ECI. Unfortunately it is impossible at this stage to distinguish the sources (employment, annual pay and merit increases, regular and irregular bonuses, commissions and stock grants) of the gains in compensation.

Nonetheless, if policymakers are focused on the traditional wage and salary gauges, they may be late in recognizing the rising cost of labor. ■