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Wages

Looking for a rise

WASHINGTON, DC

Wage growth is at last accelerating. But living standards will continue to stagnate

THE last time unemployment in Wisconsin was as low as today's 4.3% was in April 2001. George W. Bush had been president for a mere three months; *Gladiator* had just cleaned up at the Oscars. Usually, economists have to look back just one recession to gauge the strength of a labour-market recovery; in Wisconsin, they must go back two. With their talents in such demand, today's Wisconsinites might have expected bumper pay rises in 2015. Instead, they have been disappointed. Hourly wages rose by just 1.1% in the past year—and are lower than they were 18 months ago.

The Badger State is not alone. The same curious combination of booming labour market and meagre pay rises has characterised the economy as a whole for most of 2015. At 5%, nationwide unemployment is more or less as low as the Federal Reserve thinks it can go before the economy overheats. Even the broader measure of underemployment, which include workers who are part-time but want a full-time job, is at its lowest in seven years. Despite this, wage growth has been lacklustre. It was a sign of the times when, on November 6th, pundits celebrated the news that hourly pay grew by 2.5% in the year to October. Bumper by today's standard, that pace remains well below the 3.8% achieved in mid-2007, before the financial crisis hit.

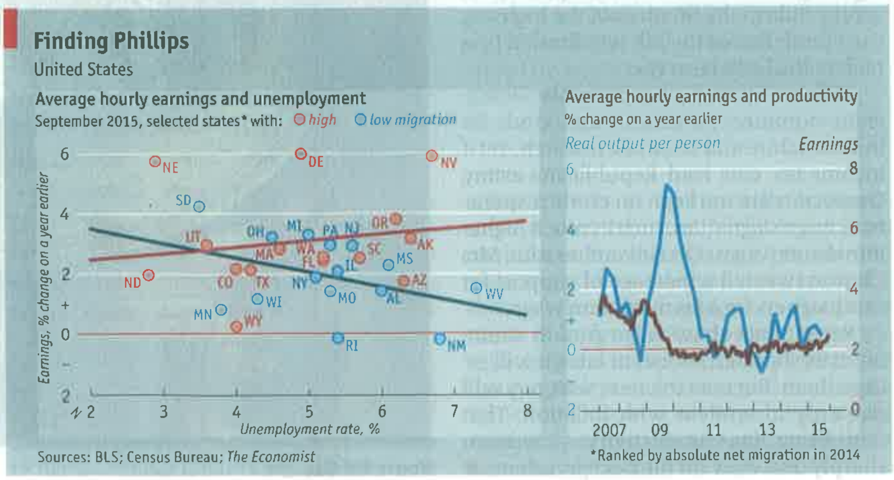
This has cast doubt on the conventional wisdom that a tight labour market leads firms to bid up wages, resulting in higher inflation. Lael Brainard, a Fed governor, recently declared that, unlike some of her colleagues, she views the labour market as an insufficient bellwether for price rises.

The link between unemployment and wage growth—the so-called "wage Phillips curve"—has flattened in recent years, for several reasons. One is low participation in the labour market. At just under 81%, the proportion of 25- to-54-year-olds in the labour force is lower than at any time since 1984. For men, the labour-force participation rate is lower than in supposedly sclerotic France or social-democratic Sweden.

Many of these potential workers gave up looking for a job during the long hangover from the financial crisis. As a result, the fraction of 25-to-54-year-olds with jobs has recovered only about halfway to its pre-recession peak. Inactive folk act as a brake on wage growth if better prospects can tempt them back into the labour force.

The same is true of migrants. Economists have long suspected that labour and capital flowing across borders may dampen the effect of employment on wages and prices. There is some recent evidence for this on a state level. Wage growth and unemployment appear related only in states where, overall, few migrants flow in or out (see chart). Workers in such states, which include Ohio, Michigan, and Mississippi, may have more bargaining power in booms and less in downturns. They also have lower overall wage gains on average.

The pickup in wage growth that appeared in October's data, if sustained, will not be enough to keep living standards rising. In the long run, that requires rises in labour productivity, the amount produced by each worker. In the aftermath of the recession, labour productivity growth fell in tandem with wage growth. In the past five years it has grown by an average of just 0.5% a year, compared with 1.9% from 2005 ▸▸



Sources: BLS; Census Bureau; *The Economist*

*Ranked by absolute net migration in 2014 to 2010, and 3.2% in the five years before that. Persistently weak productivity growth is depressing wage growth by about 0.3 percentage points, according to David Mericle of Goldman Sachs, a bank.

Falling fuel prices and an appreciating dollar have recently masked this shortfall by filling workers' wallets. With zero inflation, employees will cheer a 2.5% pay rise. Tumbling petrol prices may have kept a lid on wage demands; Mr Mericle estimates that low inflation has knocked about 0.2 percentage points off wage growth.

As inflation does eventually return, though, wages must rise higher still. Unfortunately, the productivity slowdown may be permanent. In a recent paper, John Fernald and Bing Wang of the San Francisco Fed documented how it began before the crisis—as big gains from information technology during the 1990s and early 2000s dried up—and warn that a "relatively slow pace" is the best guess for the future.

Bridge and tunnel

This is not the stuff of stump speeches. Among the candidates for the Republican nomination, Donald Trump, Jeb Bush and Marco Rubio want to slash taxes to spur productivity-boosting private investment. All promise to cut American's corporate tax rate, which at 35% is the highest in the OECD, a club of mostly-rich countries. Mr Rubio wants to encourage corporate investment further by allowing firms to deduct the full cost of investment from taxes in the year they are made.

A Republican president would inevitably pair these changes, though, with expensive income-tax cuts that would require a squeeze on public investment. That would sap productivity, especially given the deplorable state of American infrastructure. The burden of shoddy roads, airports and energy infrastructure will cost every household $3,100 a year, according to the American Society of Civil Engineers. Avoiding that should be a priority. On November 5th the Republican-controlled House of Representatives at last passed a highways bill, which should help, but left a gaping hole in the finances of the highway trust fund. Part of the bill was funded by a raid on the Fed's reserves.

Hillary Clinton, the probable Democratic nominee, promises more funds for infrastructure and scientific research. Yet if income-tax cuts lead Republicans astray, Democrats are too keen on crude responses to wage stagnation, such as much higher minimum wages. On November 10th, Mrs Clinton tweeted a message of support for campaigners for a $15 minimum wage.

Recent data show wage growth straining at its shackles; sooner or later, it will escape them. But over the next year, pay will rise only in tandem with inflation. That will bring the productivity slowdown sharply into view for the next president. ■

Electing judges

Courting cash

NEW YORK

Democrats prevail in the most expensive judicial race yet

COURTS, in theory, are bastions of independence and impartiality. But that image is tainted when campaigns pass the hat for contributions, or benefit from spending by others. Earlier this month, a race for Pennsylvania's Supreme Court was fuelled by at least $16.5m in campaign spending—the most expensive judicial election America has seen to date.

Democrats outspent the Republican candidates more than three-to-one and scored a resounding victory on November 3rd, taking all three open seats on the court to reach a 5-2 majority and increase the likelihood of left-leaning decisions from Pennsylvania's highest tribunal. Crucially, these seven judges choose the tiebreaking member of a bipartisan commission charged with drawing the state's electoral districts. So the win may pay dividends for the Democrats in state legislative races over the next decade as well.

The three Democrats elected to the Keystone State's highest court owe their gavels primarily to organised labour and plaintiffs' lawyers, their two most generous blocs of financial support. Christine Donohue, Kevin Dougherty and David Wecht, the three winning candidates, took in $2.1m from unions and another $1.7m from lawyers.

These Democratic victories ought to be troubling for Democrats. Hillary Clinton, the front-runner for the party's nomination, has railed against *Citizens United v Federal Election Commission*, a decision of 2010 that enabled outside groups to spend freely in election campaigns. The ruling, she said, protects "the right of billionaires to buy elections". But *Citizens United* is precisely the wrench that opened the spigot of outside dollars for judicial candidates in Pennsylvania.

Mr Wecht opposes the principle in *Citizens United* that spending money is protected by the First Amendment's guarantee of freedom of speech. He admits, however, that money helped the Democrats take command of the Pennsylvania Supreme Court. He ran on a platform calling for a ban on gifts to judges. "The opportunity to serve as a judge is a solemn responsibility and a public trust," his campaign declared. "The exchange of favours has no place in the judicial process."

Massive campaign spending in judges' elections, according to Liz Seaton, interim head of the campaign group Justice at Stake, "is a giant and growing storm that threatens justice". The candidate amassing the largest war-chest wins more than 90% of contested state Supreme Court races, she has pointed out. Ms Seaton and other critics think the selection of judges should be taken out of the hands of the people and entrusted to panels of experts instead.

Some members of the Pennsylvania legislature have similar plans. A Republican lawmaker, Bryan Cutler, has proposed an amendment to the state constitution establishing a bipartisan commission to scrutinise would-be judges' records. The body would send a few names to the governor, who in turn would choose a nominee from the list to propose to the state Senate for confirmation. Many states use a variant of this so-called Missouri Plan—which is named after the state which, in 1940, became the first to use merit selection. But the chances of Pennsylvania adopting such a change right away are nil. Both houses of the state legislature would have to approve the measure two years in a row, followed by a state referendum in which the people agree to give up their power to elect judges themselves. ■

Yours for $16.5m

Public services

Sharper elbows

The well-off are grabbing an ever-larger share of spending

PUSHY middle-class types are said to have a knack for getting the most out of the state. With their sharp elbows, the argument goes, the wealthy jostle others out of the way in the queue for doctors' appointments, school places and other scarce public services. The conventional wisdom is half-right. In absolute terms, Britain's poor consume more public services than the rich—but, after adjusting for need, studies suggest that the rich tend to get more than their due.

That long-standing inequality may be growing. Earlier this year the Office for National Statistics (ONS) released a trove of historical data which went almost unnoticed. It estimated the monetary value of certain public services, including education, the National Health Service (NHS) and transport, which combined offer the average household benefits worth £7,000 ($10,600) a year, more than the value of cash benefits such as pensions and jobseekers' allowance. The ONS then worked out what proportion of that spending was consumed by each income quintile. The data show that in the past 15 years, the rich have got a steadily better deal. In 2000, for every £1 spent on the poorest quintile, 56p was spent on the richest. By last year, the richest received 73p for every £1 spent on the poorest (see chart). The last time the rich received such a big share was three decades ago. What is going on?

Much the biggest of the various services analysed is the NHS, which eats up one-fifth of all government spending. One reason for its apparently growing generosity to the well-off is that the elderly, its main clients, are getting richer. According to the Institute for Fiscal Studies, a think-tank, in 2000 the average pensioner's income was 86% that of the median, whereas by 2013 it exceeded 100%.

Yet data for NHS spending on the working population show a similar trend: whereas in 2000 households in the bottom income quintile received 27% more than those in the richest, today they receive the same as each other. One explanation is that the rich are ditching their private health insurance and instead using the NHS, whose growing budget has made it a better substitute. According to LaingBuisson, an information provider, individual medical insurance covered 1.2m Britons in 2001 but fewer than 1m by 2011 (company policies remained pretty static).

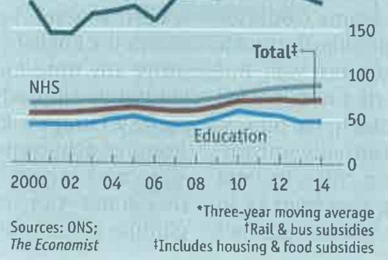
There is also some evidence that poor households are finding it harder to access the NHS. Areas with low life expectancy matched those with few general practitioners (GPs, or family doctors), found a report in 2007 by Ara Darzi, a Labour peer. Inequality in GP distribution had grown in the past two decades, it said. The OECD, a rich-country club, finds that after adjusting for need, Britain's poor are 5% less likely than the rich to have visited a GP in the past year (though this gap is narrow by international standards). Household-survey data suggest that the difference has grown lately, though comparisons are tricky.

Just as fewer people are taking out private health insurance, fewer are sending their children to private school. Since 2008 the proportion of children at independent schools in England has slipped from 7.2% to 6.9%, thanks in part to higher fees. More rich families are thus benefiting from state tuition. Yet the long-term trend in education funding is steeply progressive. In 1977 the richest quintile received 87p for every £1 that was spent on educating the poor; last year they got 48p. The biggest change during this period was in higher education, which went from being the heavily subsidised privilege of a few to a service from which about half benefit.

The strategy of inequality

Britain's public spending on top income quintile

% of spending on bottom income quintile*



Sources: ONS; *The Economist*

*Three-year moving average

†Rail & bus subsidies

‡Includes housing & food subsidies

Its funding model has become fairer, too. In 2012 the government raised the cap on tuition fees from £3,375 to £9,000 per year, thus reducing a subsidy whose main beneficiary had been the middle class. Poor students have been protected by a generous maintenance grant and relaxed terms for the repayment of loans. Their participation rate has grown at a faster rate than that of their richer peers since the reform, finds Gill Wyness of the London School of Economics (LSE). The overall progressive trend may continue: this year it became compulsory to stay in education or training until 18, a change which will mean more being spent on low-income children, who are more likely to leave school early.

The most regressive public service is transport, from which the richest quintile benefit almost twice as much as the poorest. The reason is that they travel more—and by the most expensive means. The state subsidises rail travel by £5 billion a year. Yet intercity trains bulge with well-dressed folk tapping away on laptops; each year the average top-quintile earner travels 2,300km (1,400 miles) by train, five times as much as the bottom earners. In 2002-12 the gap widened by 270km, meaning richer types gobbled up yet more subsidy.

The wealthy also drive three times as many miles as the poor. This makes them big beneficiaries of spending on roads, worth £8 billion a year (and not counted in the ONS's figures). Poor people make up ground elsewhere: they use buses twice as much. But bus subsidies are smaller, and the rich use them increasingly frequently.

What are the implications of all this? George Osborne, the chancellor, wants to close Britain's budget deficit by 2019-20, which implies very steep cuts to public spending (details will be announced in a mini-budget on November 25th). The fact that a growing share of some public spending goes to the well-off might make this task look less painful.

But it also presents a problem. Julian Le Grand of the LSE argues that the government struggled to reduce spending in the 1980s because of "its willingness to favour state-provided services that were predominantly used by members of the middle class". Mr Osborne has shown a similar reluctance to rob this constituency, pledging to protect spending on pensions, the NHS and schools (as well as foreign aid and defence). This puts the onus of deficit-cutting elsewhere; some departments will see their budgets reduced to half their level in 2010. Those seeking to keep their share will need sharper elbows than ever. ■