THE ORANGE COUNTY REGISTER

Pay should be tied to productivity

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Dec. 13, 2013

It has been almost 30 years since I started my first paid job flipping burgers at Burger King. I started out making minimum wage and was happy to have the opportunity. Despite working on-and-off at that Burger King for almost three years, one thing I did not plan to do was make a career out of it.

One of the more bizarre arguments for raising the minimum wage is that people can and should make a career of it. Encouraging large segments of our workforce to spend their careers as fast-food workers is a disservice to both them and our economy. Instead, policymakers should be focused on increasing the productivity of workers, which is what ultimately drives wage increases.

Let's first clear up some myths about who exactly works at the minimum wage. According to the latest numbers from the Bureau of Labor Statistics, over half of minimum wage workers are under the age of 25. In fact, only 3 percent of workers over 25 earn at or below the minimum wage. Two-thirds of minimum wage workers only work part-time. The biggest indicator of who works at minimum wage is education, as just 8 percent of minimum wage workers have a college degree; around one-third lack a high school degree.

The reason these workers are paid only the minimum wage is simple: they are not very productive. If we would like to see them make more, the solution is to make them more productive.

The vast majority of minimum wage workers are concentrated in the leisure and hospitality sectors, particularly the restaurant industry. Even within the trade sector, almost all minimum wage workers are on the retail side and not the wholesale side. The reason for these differences is again, productivity.

Between 1987 and 2012, productivity (output per hour) increased at an annual rate of 3 percent in the wholesale trade sector. Workers garnered much of this increase as employee compensation. In fact, worker wages increased at a faster rate than productivity, at 4.2 percent annually.

In contrast, looking at productivity in retail lines with high proportions of minimum wage workers, there was almost no productivity growth. For instance, among food and beverage stores, annual productivity growth between 1987 and 2012 was just 0.3 percent. Despite the weak productivity growth, worker compensation still increased almost 3 percent annually.

Recent protests have focused on the fast food industry. Contrary to popular perceptions, worker compensation in the food industry has actually grown faster than in others. Between 1987 and 2012, employee compensation increased at an annual rate of 5.1 percent. This is especially impressive given that annual productivity growth was only 0.6 percent over the same period.

The theory behind productivity driving wages is common sense: competitive markets will drive employers to bring compensation up to match an employee's contribution, and competition among employees will keep wages from rising too far ahead of compensation.

Long-run data support that basic theory. Since World War II, the quarterly change in productivity and worker compensation for the nonfarm business sector has shown a correlation of 0.97 percent. That is an almost one-for-one change. Yes, we can see lags or short-term fluctuations, but the data is very clear: Productivity changes are closely associated with compensation changes.

Simply having government mandate a wage increase defies logic when there is a barely discernable increase in productivity.

So how can worker productivity, and therefore wages, be increased? First, the focus of our investment policies should be turned on things that actually make workers more productive such as human capital (skills and education), or equipment that make workers more productive. Doing so is not only a “win” for workers but also their employers, the economy and society in general. Creating a more certain investment environment is probably the best thing we can do to encourage business investment in plant and equipment.

When it comes to human capital, the structural flaws in our education system must be addressed. As noted above, education levels are powerful determinants of who works at what wage. To reduce inequality, there's nothing more important than increasing accountability in education. The ultimately most effective mechanism would be increased school choice. There are also too many young men cycling through our criminal justice system. Increasing the minimum wage won't make it any more likely that a young man with a prison record and no high school degree will get a job.

Those who advocate an increase in minimum wage are at best trying to wave a magic wand and pretend deep-seated structural problems will just go away. It would be far more productive to focus on the disease, rather than obsessing on its symptoms.