

WALL STREET JOURNAL

Economic Growth Must Come First

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By James A. Dorn

January 28, 2015

In your editorial “Still Room for Growth” (Jan. 10), you refer to “a virtuous cycle” in which “higher wages mean consumers have more money to spend, which increases growth.” This argument sounds like the false logic used to justify the minimum wage, and has it exactly backwards. The truth is that real economic growth comes first and wage growth second.

What drives real growth is not an increase in money wages but changes in the underlying forces that increase output per worker. Those include adding to the capital stock, improving workers’ skills through education, better technology and most important, institutional changes that provide incentives to expand plant and equipment, join the labor force and promote economic freedom.

The Federal Reserve’s near-zero interest rate policy has deprived households of interest income and discouraged saving and investment, while other government programs have encouraged workers to take taxpayer-provided benefits rather than enter the work force, and a host of onerous regulations discourage employers from hiring new workers. Finally, employers will have less incentive to increase wage rates when the cost of providing health insurance and other non-pecuniary benefits rises.

Average hourly earnings remain stagnant because of slower productivity growth due to the above factors. Until the ultimate determinants of economic growth gain ground, there will be no virtuous cycle.

James A. Dorn is vice president for monetary studies, editor of the Cato Journal, senior fellow, and director of Cato’s annual monetary conference.