Episode 1,232: Are Workers Getting Shafted?

Guest: Gene Epstein

WOODS: Okay, let's talk about now what our subject matter for today is. A great thing about Gene is there'll be some economic factoid, some position people are sure of, they just know is true. And Gene’s actually put in the homework, and he knows the reality of the thing. So these days, one thing that we're hearing quite a bit is that the relative position of workers has been declining for various reasons. And it could be, you know, the decline of labor unions, or it could be the increase in free trade, or it could be terrible Republicans in office who just want workers to die. Whatever the explanation is, the workers' share of, I don't know if it's national income, but their share has been declining. And obviously, the implication of that is some public policy response is necessary. So, Gene, you've been looking at this and you say that, actually, everybody's getting this wrong. Now, how could everybody be getting it wrong and Gene Epstein's getting it right? Help us out.

EPSTEIN: Well, Tom, let me claim my credentials. I covered the very imperfect data issued by the statistical agencies for more than a quarter of a century. And one of the things that I did over the years was cultivate people at the statistical agencies and really get into the data. And I found over the years that mistakes on all sides of the aisle were legion on the part of *The Wall Street Journal*, especially on the part of *The New York Times*, especially on the part of Paul Krugman. I did publish a book in 2006 called *Econospinning: How to Read Between the Lines When the Media Manipulate the Numbers*. I was accused by people like Brad DeLong of being very right-wing, when in fact, I had a chapter called a "Bush League Economics," in which I indicted at *The Wall Street Journal* for their poor coverage of the data. So this is something I've been doing for years. I still have a brain trust out there of people I speak to about how to measure these things.

But let me also emphasize that I approach all data from the standpoint of being a guy who's still wears, amazingly, the Murray Rothbard sweatshirt. And while on the one side, I recognize that there's a bias on the part of *The New York Times* and on the part of others — you know, that any stick you can beat capitalism with, let's do it. If the numbers superficially show that something is not right, then let's run the numbers. Let's run the chart. Let's not ask any questions. Because after all, we must assume that labor is always getting shafted, that the worldview, the economic understanding on the part of *The New York Times*, to single them out, but there are many others, is that labor is always at a disadvantage; that labor in a way must always be getting exploited; that employers have all the power.

And this is of course something that historians suffer from. You must know this, as laborists don't know anything about labor economics. George Reisman — I recommended that you do an interview with him. I mean, they all believe in exploitation theory. George has a nice line that they all latch on to two concepts: worker need and employer greed. The workers all need a job. Employers are very greedy. They don't want to pay them any more than subsistence, and therefore, unless you have government involved, they'd only be earning subsistence. Well, in fact, basically, the reality is that you have a labor market out there. The labor market is such that workers at the margin, at least, 20%, 30% of workers, shop around. Employers are basically bidding for them. This, of course, is disturbed by business cycles, but once you have accrued the measurement of unemployment, right around 6% or less, as we've had since 2014, it's very unlikely that labor won't more or less get the same kind of share it used to. It's very unlikely that the numbers will not pretty much bear out that labor's share is fairly stable.

Well, what I found — I don't know if you want me to get into the weeds of measurement, Tom. What I found is that if you look at data released by the Bureau of Economic Analysis, all the tables, all the statistical tables that are published on their website, I wrote an article for Reason.com in which I laid out the numbers, I provided a link to a little appendix in which I make every line I use completely transparent, that if you compute the numbers fairly, you find that labor share is admittedly at the low end of the statistical range since 1947. But labor share, for example, is now running equal to or higher than the mid 1990s, when nobody was complaining about labor share. And all of this has to do with various amateur errors people make in calculating the numbers. Now, I don't know how much you want me to get into the weeds with that, but that's the basic overall finding that I post in this article, which will be on the on the show notes page, "Are American Workers Getting Shafted?" No, they're not.

WOODS: I think it just seems hard to believe for people, because not only have they heard the opposite, but the opposite is driving almost every debate on every economic issue out there.

EPSTEIN: Sure. On a related point, Tom, I sent you another piece — you know, I actually still contribute to a *Barron's* online publication. And I have a column called "Economist's Corner." My column used to be called "Economic Beat." That's been retired for good, but my column is now "Economist's Corner." I did an update on the idea that — just yesterday, I mean, Senator Schumer, our local senator from New York State, made the same statement that wages are stagnating, that inflation is clobbering wages. And this is really a problem, a bigger problem, by the way, than the labor share idea, because if you actually patiently go through the numbers about how to measure what is — labor share is labor share of total output. And as I patiently explain in my article, you have to know how to compute the numerator and how to compute the denominator. I mean, one of the key mistakes that is being made is that they include government in it, and government actually distorts the trend. I'm able to focus, because I know the numbers. I can back up and focus on compensation in the private sector, compensation and output in the private sector.

I might mention that Krugman, of course — I don't mention Paul Krugman in this article, but Krugman outdid himself by calculating the denominator wrong and then in compensation, he didn't even include benefits, which almost everybody includes in compensation, because benefits went up a huge share over the last 20 years. He just cut out benefits. So of course, when Krugman does it, he's really off the deep end. When others do it, they don't know to take out government. There are other technical issues having to do with the denominator. They don't know how to compute net output rather than gross output.

What's happened over the decades is that depreciation, capital consumption is a much larger part of output than ever before. It's interesting news. In fact, what's been happening is that business has been investing in equipment and software far more than they used to. In the '50s and '60s, they invested far more in plant. Now they're investing far more in assets that depreciate very quickly. And of course, obviously, the only way for employers to pay anybody is out of net output because they have to keep replenishing their capital. That's another key mistake that's being made. And so once I correct for that, the share is well within the historical range, and as I mentioned, higher than in the '50s and '60s, higher than it was in the mid '90s.

But let me get to the other part of it, which has to do with inflation and wages. The inflation, now you do have to — in this economy, with inflation, you do have to inflation-adjust wages. And the inflation measures are really troubled. Now, as with all thing, Tom, you and I are always asked: what would Murray will say? And this is an interesting story about Murray Rothbard. Now, the fact is that Murray was able to show that these price index calculations are very, very problematic. In fact, in his textbook write-ups, he pretty much repudiated the whole idea, and let's say he was basically right.

But let me tell you something else about Murray, which I mentioned, by the way, in this essay I wrote about him, the introduction to Murray Rothbard's essays that I was privileged to write. But the one moment I caught Murray Rothbard but being a little bit hypocritical is I heard him do a lecture — there are lots of great recordings of Murray Rothbard's lectures. But he's lecturing about the post-Civil War period. And lo and behold, he starts talking about inflation adjusted by output and wages. And he's suddenly using a price index, the very sort of thing that he said is just verboten and crazy Well, the truth is that we are sort of stuck with this crazy idea of using price indexes.

Now, but let me get to the next part of the story, which is this: the price index that everybody uses is a price index called the consumer price index, the CPI, which is Generated by the Bureau of Labor Statistics. And you ask yourself: why is the Bureau of Economic Analysis, you know, supervised, why is it run by the Bureau of Labor Statistics when it's supposed to be prices? The Bureau of Economic Analysis, which runs the national income and product accounts, why aren't they in charge of the headline index? Well, this is an interesting history, which gets to the incredible long-term bias in the consumer price index as run by the BLS.

Originally, the CPI arose in 1913, when there was already workers in the ship yards, and there was this idea that inflation might heat up and that war might break out — and indeed it did. You know, war broke out in 1914, and then the U.S. entered the war in 1917. And of course, whenever there's a war, whenever the U.S. is gearing up for war — and indeed, 1913 is the year the Federal Reserve got inaugurated — then inflation heats up. Now, this is the moment when, as Murray says, we Austrians observe, we free market people who observe that there is a connection between the creation of the Federal Reserve in 1913 and the entry of the U.S. into war.

Well, inflation was heating up, and workers were in the shipyards, and there was a fear that they would strike if prices got too high, if they weren't paid adequately. So the BLS — I think it was not quite called the Bureau of Labor Statistics then, slightly related name to labor — they were asked to compile a price index to adjust wages in the shipyards. So that's how they got their hooks into the CPI, into a consumer price index. And bureaucratically, they held on to it. And then by the 1970s when inflation — let's jumped to the 1970s. Inflation is heating up, and suddenly the CPI becomes the index of choice for adjusting alimony payments, adjusting Social Security payments.

And there is a long history of being very sort of progressive-, labor-, left-wing-oriented at the BLS to make sure that that index is pretty stiff. It's very, very rigid, and it greatly overstates inflation, and this has been recognized for a long time. Now, by the way we could talk about —

WOODS: Wait a minute. Do you mean to say that it overstates inflation?

EPSTEIN: Indeed, it does, Tom. I know, was about to say that — I think the economist is named John Williams. There are a lot of people who believe that the CPI understates inflation. Is that what you were going to raise doubt about this, Tom?

WOODS: Well, I'm curious because I'm not convinced by John Williams myself.

EPSTEIN: Okay.

WOODS: So I just wanted to clarify that that is what you intend to say.

EPSTEIN: Sure, absolutely. I'm sorry, I'll talk a little bit more slowly, sorry.

WOODS: Well, just because I think people will be surprised to hear that.

EPSTEIN: Well, let me let me assure challenge to John Williams. He's a nice guy. Look, John Williams says that inflation has been running at least 4% — I believe he's up to 6%. I know it's at least 4%, because that's what — and I mentioned 4% and 5%, I think he's ta 6%. Because what that basically means is that, if John Williams is right, then there has been no economic growth at all since the 2008, 2009 Great Recession. None at all. And that's because nominal gross domestic product or private sector gross domestic product, however you choose, has only been rising by 4% a year. So if you introduce an inflation — so in other words, actually of course, the deflator that's being applied, GDP has been running 2%, and that's how nominal GDP of 4% becomes 2% real growth, which I believe is about accurate, and 2% is pretty dismal. But if you're going to believe John Williams' 6% or even go up to 4% or 5%, then you have to believe that absolutely nothing has been happening in terms of economic growth or in terms of the increase in economic output over the last nine years.

Now, the reason I think that — now, I looked it up. I think John Williams actually specifically says that, and then I have to tell John Williams: we have so much data independent of GDP to demonstrate that something's been happening. We have, for example, the unemployment insurance rolls — you know, maybe it's not understood that there is something called the universal count — little misnamed, but you know, that 98% of companies are registered with the unemployment insurance in their state, and all the data that they compile is taken in by the Department of Labor so that they have to, as a matter of law, record people on that payrolls who file for unemployment insurance. They have shown a dramatic increase on the payrolls just in this independently reported source of private sector employment. So how would so many millions of people be added to payrolls over the last eight, nine years if there wasn't some kind of economic growth? Has the private sector gone completely nuts? I mean, we have other — we have retail sales, Census Bureau-run surveys of retail sales, independent retail sales — we have so much independent data showing that there actually has been noticeable economic growth. So if you're going to believe John Williams' data, I want to say to those who do: then you have to believe that we've actually been shrinking in terms of output over the last eight, nine years. So I mean, that's a digression, Tom. I want to address those people and say: that's a killer reductio ad absurdum.

But I do want to get to the point that, if you actually look at the CPI and all that it misses and look at the tradition of the Bureau of Labor Statistics to basically be labor-oriented, basically be on the side of those who get clobbered — I mean, that's very nice of them. Now, if you examine so many other statistical traditions of the Bureau of Labor Statistics or talk to these people, by and large they're basically very left-leaning. That's the tradition at the BLS. I mean, they have a very rigid index, and basically if plums get pricier than nectarines, then they don't assume that there might be a shift. The way they categorize and rigidly categorize all the prices then it basically goes sky high, they have a great — 40% of the CPI is residences. Two-thirds of households own their own homes, and yet they have a crazy attribution. The Bureau of Economic Analysis, which has a more mainstream tradition, does not use the CPI. It has to use their survey data, but it has its own index called the Personal Consumption Expenditures Deflator, which is it uses for consumer spending. It does not use the Bureau of Labor Statistics' CPI.

And by the way, I hate to sound too wonkish, because I'm not exactly impressed by the intellects at the Federal Reserve, but the Federal Reserve has had a long tradition of looking at the Personal Consumption Expenditures Deflator, which rises much more slowly. Any period you choose, the mark rises much more slowly than the CPI. And it too might be a bit troubled. Now I'm pursuing this point, because in this other article I wrote — which I'd like you to post on the show notes — that I wrote for Barrons.com, I talked about how it's a complete myth that, even over the past year when oil prices and energy prices have been very high, that wages have not been keeping ahead of inflation. There's a little question that since 2014, wages have been keeping ahead of inflation, have been rising faster than inflation, which is pretty much what you'd expect when the unemployment rate, officially measured, falls below 6%.

And for this, I also, by the way, have a problem with — I mean, I could get into the long story of the way in which the BLS has measured wages. For many years, it measured only the wages of production workers, an old-line concept, a manufacturing concept that you can make a distinction between production workers and supervisors. And then they changed the name to this measure from production workers to production and non-supervisory workers. And then they sent out surveys, and so many firms are not filling them out, because non-manufacturing firms and so many other firms, they don't know who's a supervisory worker and a non-supervisory. All crazy numbers.

But I have found, with the help of my old brain trust, that there is a measure from the Bureau of Labor Statistics that's called the labor economic cost index, the economic cost index of labor. That's a quarterly index. It started around 1980. That's how far it goes back. It's a quarterly index, and it's interesting. It surveys companies quarterly by asking them: what was your labor cost? What was the cost of labor? It's a quarterly number. And interestingly, the striking point about these numbers, about the economic cost index of labor, is that it has a much more orderly pattern in terms of following what you would regard as a plausible reaction to different business cycles.

And so it seems like a much more robust and reliable number than the numbers that *The New York Times* posts or that appear every month in the employment report of the Bureau of Labor Statistics — very, very volatile survey numbers that don't follow any kind of interesting patterns. They don't seem to conform to what you'd expect would be happening. The economic cost index, also compiled by the Bureau of Labor Statistics, is more reliable. All I'm saying is that — all I say in this article is that, if you use the economic cost index, as compiled by the Bureau of Labor Statistics, through the second quarter of this year, and if you use the Personal Expenditures Consumption Deflator, as compiled by the Bureau of Economic Analysis, then you do find that compensation of labor has been consistently keeping ahead of inflation.

And all I would say, what I say to my critics about this is that: look, what's most plausibly happening. And if you want to say that, for some strange reason, labor is not being remunerated ahead of inflation, or for some strange reason, labor is not keeping its share of output — if you want to say that, then you should find — and then it should be something that could be confirmed by the Bureau of Economic Analysis numbers. But the Bureau of Economic Analysis numbers invalidates that claim. So it should be validated by the Bureau of Economic Analysis.

Similarly, if you want to say that wages are not keeping ahead of inflation, then you should be able to show that the economic cost index of labor is not keeping ahead of the Personal Consumption Expenditures Deflator. I would say, beyond that, that these are better measures, that BEA has a better measure of these things and that the economic cost index is the best measure of labor compensation and that the Personal Consumption Expenditures Deflator is a fairer measure of inflation. But even aside from that, if you want to say something's amiss, something's crazy going on, then you should be able to prove it through the data that I cite. And the data that I cite invalidates all of those claims. It shows that pretty much labor markets have been behaving pretty much as you'd expect at this stage in the business cycle when the unemployment rate is at 4%.

WOODS: All right, Gene, even without getting into the weeds of how you gather the data —

EPSTEIN: Sure.

WOODS: — I think a lot of people would push back just from a gut instinct that: how could democratic socialism be gaining so much steam if there weren't a kernel of truth to what they're saying? Maybe they have the diagnosis wrong, or, you know, they have rather the prescription wrong. But surely, they've got to have some kernel of truth in their diagnosis of the situation. So how can you be right and yet this phenomenon is still happening?

EPSTEIN: Well, I would say that — I mean, I guess you and I could say a number of things about that, Tom. You could say that, for example, in those so-called — just when you want to talk about democratic socialism, if I can start sort of on a high-level sort of abstraction, that in those so-called democratic socialist countries like Sweden and Denmark, they actually, according to most measures of the economic freedom index, especially in respect for property rights, they're actually more capitalist than we are. Second, of course, I could say that, while democratic socialists had been getting traction — and it's possible the minimum wage laws are going to do something — they've been getting traction in politics. But the idea that they basically are running the way the labor markets operate is a little bit dubious.

I guess I could say further, that the arguments that have been made for why labor has been getting shafted violate our understanding of labor markets. You mentioned a couple of them. Well, the decline in factory jobs as a share of the labor market. Well, in fact, factory jobs — this actually can be shown by citing any kind of data from the Bureau of Labor Statistics. Factory jobs don't pay as well as construction jobs. Factory jobs, on balance, pay just a little bit better than non-factory jobs. And to the extent that factory jobs do pay better, it's obviously due to the fact that they are more unionized than non-factory jobs. And in fact, of course, we could get into that, which is that — then, of course, the declining unionization. the union representation in the private sector has been another factor. And as you and I know, to the extent that unions can have any real effect, it's that they raise the wages of those people in the union sector, but then they lower — they cause some inequality in wages, because then they make jobs less available in the union sector, and then those workers who can't get jobs in the union sector go to the non-union. So that's the reason for some disparity.

But unions or lack thereof, cannot make any difference. Cheap foreign labor has been cited, the fact that companies are using cheap foreign labor more than ever. And that's a completely sort of bogus argument, the idea that when more of our output is produced by cheap foreign labor, that necessarily means that domestic labor has to take less. Means nothing at all. It's just that — I mean, obviously, if there's work for domestic labor, as there has been certainly since 2014 and even before then — if there are jobs for them, then they will take the jobs that are given then, and of course domestic labor benefits through the Walmartization of our economy, that in fact, of course, domestic labor is by those cheap, foreign goods that foreigners are providing for us. And so cheap foreign labor is not an issue.

Then there's the wild idea, which came from a respectable source, a Brookings study, which claimed that this idea of monopsony. I call it "this idea," because this is not a term that you even encounter a lot in a textbook. Monopsony just means one buyer, or oligopsony means a few buyers. But what's been happening, according to this Brookings study, is that companies have been banding together and they've been plotting against workers, that they won't poach each other's employees. And that means then that the labor markets are sort of stuck with one employer and other employers, that you can't take your services to another employer to be bid up, because they have an under-the-table deal not to employ you and not to poach on each other.

And I mean, there's no evidence that this Brookings piece submits. The only thing they keep harping on is that, for example, that McDonald's franchises don't poach on each other's workers. Now, maybe that's true. I guess if you are franchising McDonald's and there's another McDonald's franchise a mile away, that you won't poach on each other, but they don't ever claim that Burger King and Wendy's participate in this. And we know most plausibly that since Burger King and Wendy's compete fiercely for customers, they compete fiercely in terms of quality and price and in every other way, the idea that they're not competing for workers is ridiculous.

And so none of the standard explanations apply. And again, to return to the point about a socialism, look, indeed, I guess if Elizabeth Warren has her way, something's going to happen. I should mention, in answer to your question as well, Tom, that in the back of my mind, maybe there's something in that it's a little bit tougher for labor to move, let's say, to New York or to San Francisco, where real estate is very high. And of course, the solution to that is unwind all the ways in which real estate is locked up by government. But that probably is not that big a factor. In any case, the numbers don't bear it out. Because by the way, probably there's been a countervailing trend. A lot of employment can move to locations where workers are. I think that's an interesting and under-researched point, that obviously labor migration makes a big difference in the labor market. And there's been mass migration, but for example, call center work and all kinds of other work can be done from different sources. And companies are often pursuing labor in areas where labor is cheaper and going to those areas. So I think that's a countervailing factor as well.

And so there's nothing much to the argument. And again, going back to the point: the threat of market socialism has been in politics. But so far, so far, it hasn't made a whole lot of difference in terms of economics. And by the way, I should even mention that, with respect to the minimum wage laws, the very visible firms are going to have to comply with the minimum wage laws, but it's very, very difficult to enforce those laws for others. And for so many companies that are under the radar, it's actually a fair bet that companies are going to take the risk and pay market wages, because the likelihood that they're going to get caught and pay a fine is very unlikely. So again, market socialism has not descended on the labor markets. And again, I repeat, I come up with very solid numbers that show that the idea of labor share has declined, that cannot be validated. It's invalid, according to BEA, numbers in terms of the idea that labor's wage has not kept up with inflation or kept ahead of inflation is invalidated by a respectable series issued by the BLS, the economic costs index of labor, and the Personal Consumption Deflator of the BEA.

WOODS: All right, well, Gene, we're going to call it quits for today, but I will make sure and link to your piece at *Reason* and your piece over at *Barron's*.

EPSTEIN: Thanks, Tom.

WOODS: Those will be linked at TomWoods.com/1232, as of course, will you also find a link to the Soho Forum, which is TheSohoForum.org, because if you can't make September's event, you've got to make something. I mean, certainly, let's say something about your October event.

EPSTEIN: October 15th, we're shifting to a larger hall because, there are indeed about 20,000 socialists in New York City, at least, and you know, almost includes our Mayor de Blasio, who really did make a very socialist statement about how he wishes government ran the entire housing market. I'm going to be debating Bhaskar Sunkara, a very prominent socialist. He's an officer of the Democratic Socialists of America, of New York City, and he's going to be defending a resolution about how socialism is more effective than capitalism in bringing freedom and prosperity to the masses. And so I want a lot of socialists to come, but I certainly want Tom there and others to cheer me on little bit, albeit silently, when I take on the socialists about this issue. Because we do really have to meet with these people. And I actually liked Bhaskar Sunkara. I met him several times, and indeed, he's almost a kindred spirit. I like the guy, and I think it'll be a very friendly debate. And I think I will make the case for capitalism, in terms of freedom and prosperity, effectively to the socialists. So, please come, October 15th.

WOODS: Yeah, that promises to be a doozy, and it's the debate we've been waiting for. So definitely check out TheSohoForum.org, and Gene, I'll let you go, but thanks again, as always, for some great information.

EPSTEIN: Thanks a lot, Tom.