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# Economy Remains Strong: Unemployment Is Low and Workers Are Sharing in Productivity Growth

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With the midterm elections barely a month away, the state of the economy has become an increasingly political issue. Many candidates have claimed that the economy is doing poorly and that growth has not been passed on to workers. In an election year, it's expected that politicians will take some liberties with the facts. But, in the case of the economy, politicians should not get away with spinning gold into straw to score political points. While the economy is not doing as well as it did at the height of the tech bubble, it is still growing strongly.

## Economy Doing Well

The long-term trends show that the economy is in fact doing well. Since January, businesses have created over 1.2 million new jobs. Over the past four quarters GDP has increased by 3.5 percent, above historical rate of growth. Inflation-adjusted worker compensation has risen at over a six percent annual rate in the first half of the year. These are not the signs of an anemic economy.

The September employment report stands out against these trends and appears to support the view that the American economy has faltered. The economy only created 51,000 new jobs in September, the fewest since Hurricane Katrina ravaged the Gulf Coast last year, and it lost even more manufacturing jobs.

First glances are often misleading. It is important to look deeper and at longer trends. Today, few Americans are out of work. The unemployment rate fell in September to 4.6 percent, an extremely low number historically. Aside from the tech bubble of the late '90s, the unemployment rate has not fallen below 4.6 percent since 1970. The unemployment rate only dips this low when the economy is doing quite well.

The number of jobs created and the unemployment rate differed because they were calculated using two different surveys. The number of new jobs comes from a survey of business establishments while the unemployment rate comes from a survey of workers. Unlike the establishment survey, the household survey showed that employment increased by 271,000 new jobs in September, while the number of unemployed workers dropped by 170,000.

Moreover, the September jobs numbers are only preliminary. They are released before all the data is available to the government statisticians who calculate them. Those statisticians subsequently revise the numbers when more information becomes available. For example, the Bureau of Labor Statistics (BLS) estimated that businesses created 128,000 new jobs in August, a relatively weak figure. Now, with more information, it estimates that employers added 188,000 new jobs that month—a

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*www.heritage.org/research/economy/wm1233.cfm*

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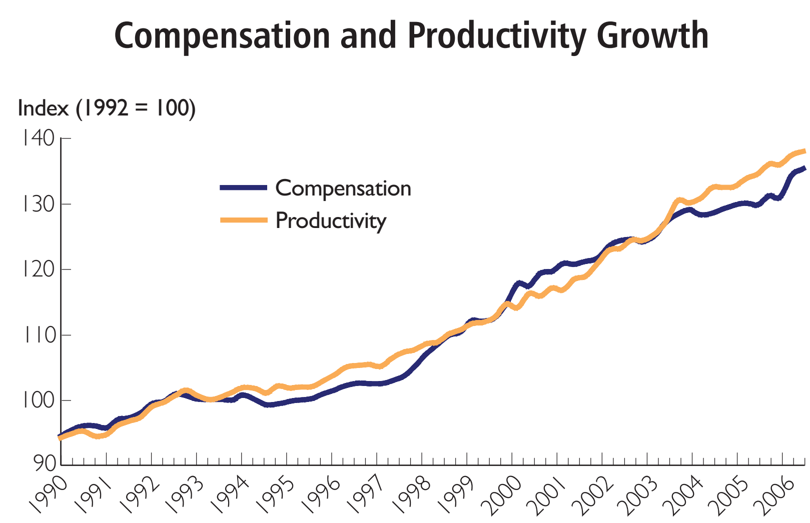
fifty percent upwards revision. BLS also undercounted the number of new jobs created between March 2005 and 2006 by 810,000. The new jobs numbers are preliminary and provide an incomplete and rushed portrait of the economy.

Chart 1 WM 1233




**Source:** U.S. Department of Labor. Bureau of Labor Statistics. "Productivity and Costs." Nonfarm business sector. Compensation adjusted for inflation using the implicit price deflator for Nonfarm Businesses.

## Workers Share in Productivity Improvements

Often politicians explain that, even if the economy is doing well, workers are getting shortchanged. They point out that, while worker productivity and worker wages have usually risen together, recently workers' total compensation has not kept pace with increases in productivity. Between the end of the 2001 recession and now, productivity in the nonfarm business sector has risen 15.9 percent, while inflation-adjusted total worker compensation only rose 11.7 percent.[1]

However, the recent difference between wages and productivity is neither unusual, nor evidence that workers are getting shortchanged. Wages and productivity move together over the long term, but often do not move together during the course of the business cycle. Productivity also grew faster than compensation for several years after the recovery from the 1991 recession. At this point in the recovery from the 1991 recession, productivity had risen 8.4 percent while compensation had only risen 5.2 percent.[2]

After the 1991 recession, workers' earnings did not rise as fast as productivity until 1997.[3] Then, as the unemployment rate fell and companies faced competition to hire increasingly productive workers, incomes shot up. By 1999 employee compensation had fully caught up to the productivity gains of the early 1990s.

That productivity has risen faster than compensation during the recovery from the most recent recession is no more a call for alarm now than it was in 1996. With extremely low unemployment and workers in scarce supply, these productivity gains will translate into income gains for American workers over the course of the business cycle. There are many signs that this process has already begun. Chart 2 shows the year over year change in productivity and inflation-adjusted worker compensation. In the second quarter of 2006 employee compensation grew faster than productivity for the first time since 2001.

1. Source: Author's calculation based on data from the U.S. Department of Labor. Bureau of Labor Statistics. "Productivity and Costs." Nonfarm business sector. Q3 2001 to Q2 2006. The implicit price deflator for Nonfarm business was used to adjust the series for inflation, not the traditionally used Consumer Price Index. The implicit price deflator was used here because an output price deflator is the correct deflator to use when comparing compensation and productivity growth, since productivity is calculated using output data.

2. Source: Author's analysis based on on data from the U.S. Department of Labor. Bureau of Labor Statistics. "Productivity and Costs." Nonfarm business sector. Compensation deflated using the implicit price deflator. These figures are measured 19 quarters out from the end of the 1991 recession, from Q1 1991 to Q4 1995.

3. Ibid.

## Conclusion

Contrary to much election rhetoric, the economy is doing well. The establishment survey showed that only 51,000 new jobs were created in September, but this jobs number is preliminary and subject to future revision. Most other measures show a strong economy. The unemployment rate has fallen, and GDP is growing robustly.

Contrary to various claims, businesses are not refusing to pass on productivity gains to their workers. Productivity rose above compensation for a short period of time in the early- and mid-1990s. Then, as the unemployment rate fell and companies had to compete for workers, compensation caught up to productivity gains. Today, evidence suggests that we may have already reached this point in the economic cycle.

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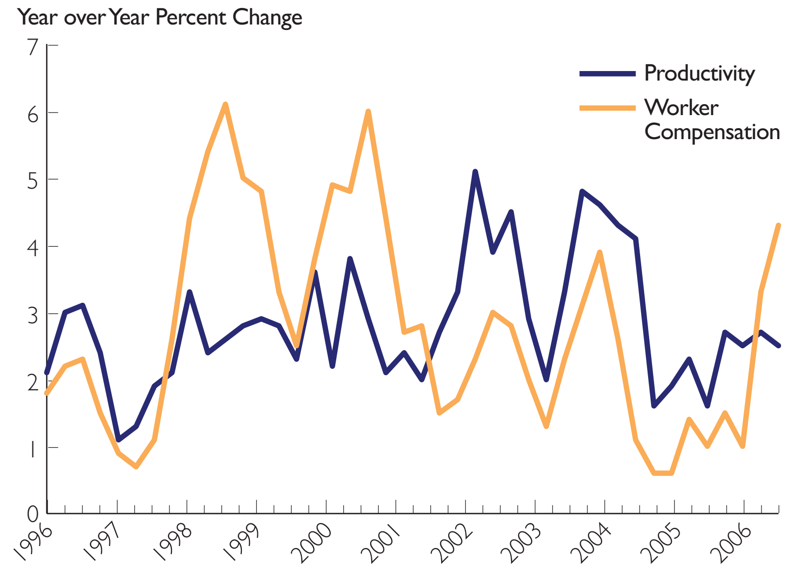
Chart 2 WM 1233

**Changes in Worker Productivity and Compensation**




**Source:** U.S. Department of Labor. Bureau of Labor Statistics. "Productivity and Costs." Nonfarm business sector. Compensation adjusted for inflation using the implicit price deflator for Nonfarm Businesses.