

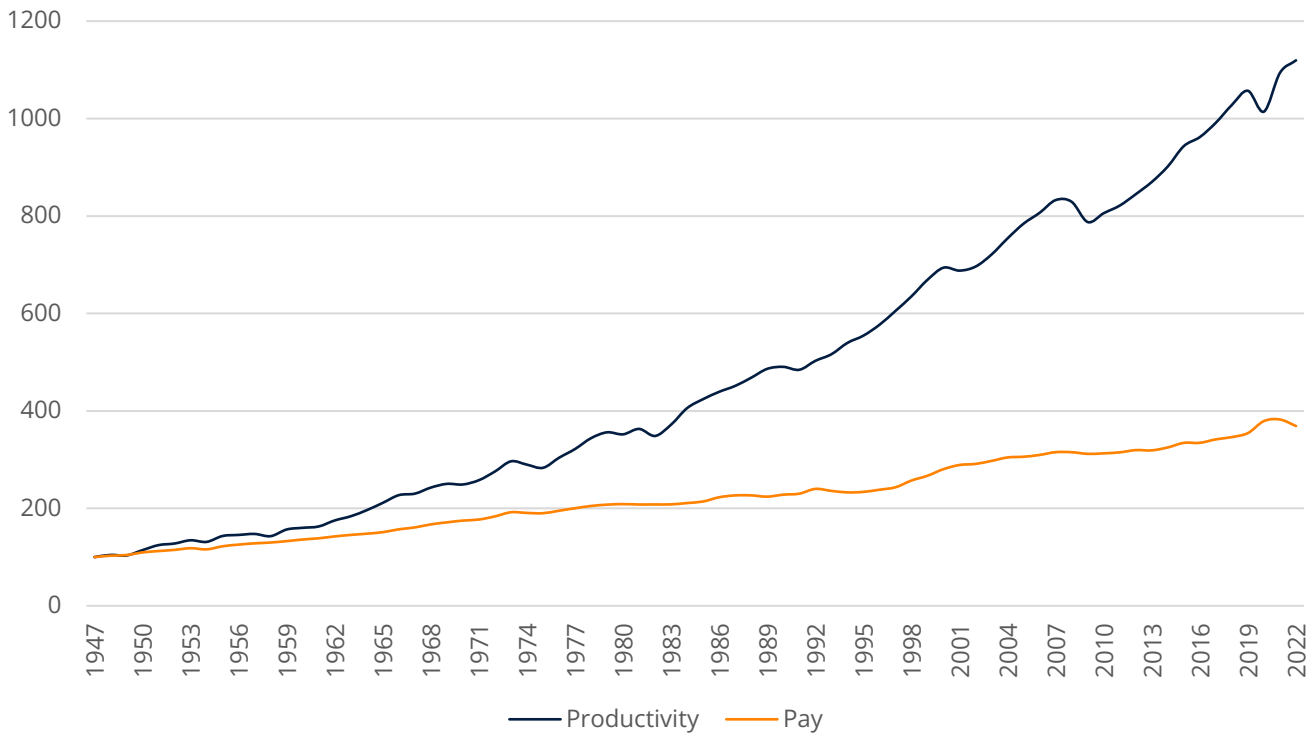


## Understanding the Workers' Pay and Productivity Gap

Since the 1970s, one of the most popular and misunderstood topics has been the gap between workers' pay and productivity. This disparity has sparked considerable debate among economists, policymakers, and the public, leading to various theories and explanations about its implications for the economy. A common narrative suggests that while workers' productivity has continued to rise, their inflation-adjusted pay has not. In 2022, President Biden's [Council of Economic Advisers](#) noted, "The divergence between the two trends suggests that there may be forces suppressing the pay of workers relative to their productivity," reinforcing this notion. However, the reality of workers' pay and productivity is much more complicated.

Labor productivity measures economic performance by comparing the amount of output with the amount of [labor used to produce that output](#). For example, if you work extra hours for a week to complete a project, the government does not consider you more productive because the increased output is due to additional work hours, not greater efficiency. This distinction highlights the complexity of measuring labor productivity and contributes to the problematic nature of current analyses of workers' pay and productivity growth. As highlighted by [Peter Coy \(New York Times\)](#), there are significant discrepancies in researchers' definitions and calculations of pay and productivity, leading to varying economic interpretations.

FIGURE 1. THE PRODUCTIVITY AND PAY GAP PUZZLE (1947 = 100)



Source: BLS and calculations by the authors.

For example, the [Economic Policy Institute \(EPI\)](#) compares the pay of production and nonsupervisory workers with the overall productivity of the economy, including areas beyond their control, like the output from supervisors, the self-employed, farms, and government. In contrast, the [American Enterprise Institute \(AEI\)](#) focuses on nonfarm business pay and productivity data. This difference makes the EPI study show a much more dire economic situation, while the AEI study minimizes the economic problem.

Another complication is that while those at the top of the income scale have seen significant increases in their earnings, the median person (and those earning below the median) have not experienced similar growth. This divergence results from different productivity growth at different income levels.

Interestingly, this divergence in pay and productivity manifests differently across gender lines. According to [Scott Winship \(AEI\)](#), women have seen much larger gains in compensation growth than men, with women experiencing an 84 percent increase compared to a 30 percent increase for men. Winship argues that this shift is largely due to changing traditional gender roles. Historically, men were overpaid relative to their productivity because they were seen as the sole breadwinners, while women were considered homemakers. As society moved away from these traditional roles, both men and women saw their pay become more aligned with their productivity.

Additionally, this period saw a transition in the U.S. economy from being manufacturing-heavy to service-oriented, further influencing these trends.

Despite the puzzles that data shows, [James Sherk \(Heritage Foundation\)](#) reinforces this difference in calculations and methodologies by stating that researchers are comparing 'apples to oranges' when looking at data on productivity and pay. Using data from the Bureau of Economic Analysis and the Bureau of Labor Statistics, Sherk finds that researchers who state that there is a large gap between productivity and wage growth have **committed three calculation errors**. One is comparing the pay of only some workers to the productivity of all employees. Two, they count the productivity growth of the self-employed but exclude their pay growth. And three, different measures of inflation are used to calculate pay growth and productivity. These three issues, Sherk points out, explain "all but 4 percent of the apparent gap between pay and productivity." The bottom line is that the puzzle is due to statistical issues, not a broken-down economy.

The complex landscape of productivity and compensation highlights the importance of accurate analysis. Addressing the calculation problem requires researchers to **measure workers' productivity accurately** without politicizing the issue and focus on economic theory. Instead of viewing the economy as inherently broken, policymakers should concentrate on raising overall productivity. This effort should particularly aim to enhance productivity for working- and middle-class earners, thereby addressing income inequality and ensuring equitable economic growth.

## About the authors

---



Karla C. Hernández  
Master Research Assistant  
Center for Free Enterprise  
[kchernandez1@miners.utep.edu](mailto:kchernandez1@miners.utep.edu)



Dr. Nicolas Cachanosky  
Director  
Center for Free Enterprise  
[ncachanosky@utep.edu](mailto:ncachanosky@utep.edu)  
915-747-8611



Dr. Louis Rouanet  
Assistant Professor  
Center for Free Enterprise  
[lcrouanet@utep.edu](mailto:lcrouanet@utep.edu)  
915-747-5239



# WORKING PAPER SERIES

## Dollarization and Default Risk: A Brief Note

C4FE Working Paper Series 2024/06

*Emilio Ocampo and Nicolas Cachanosky*

In this brief note, we evaluate the conclusions of a recent paper by Lopez Almirante and Neumeyer (2024). Simulations of a well-known model calibrated for Ecuador led them to conclude that dollarization can lead to a higher probability of sovereign default and that only a high inflation rate would make it a welfare-enhancing option for a non-dollarized economy. We find data misspecification and erroneous assumptions invalidate the results of the analysis.

