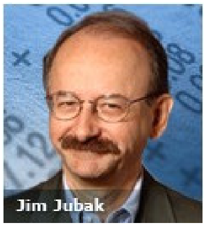

Jubak's Journal 11/7/2006 12:00 AM ET

Why higher wages should worry you

Wage inflation is back, which means workers are getting a bigger slice of the economic pie. The bad news? That cuts into corporate-profit growth, the driving force in the stock recovery.

By Jim Jubak

Wage inflation is back. And it couldn't be showing up at a worse time.

Thanks to wage inflation, the slice of the national income pie going to corporate profits, which has been growing steadily since 2001, looks like it has peaked. And it has peaked at a time when economic growth is slowing. Together, these two trends could mean an end to the string of 18 consecutive quarters of double-digit earnings growth for the **S&P 500 Index** ($INX, news, msgs) that has underpinned the stock market's recovery from the crash of 2000.

And there's no quick fix available to the policymakers at the Federal Reserve who set interest rates.

Count this as just one more uncertainty, one more thing to worry about -- along with interest rates, economic growth, the dollar, oil prices and inflation -- in 2007.

Corporate profits near peak of cycle

The Commerce Department breaks down national income generated by the U.S. economy into slices. There's one for corporate profits, for example, and another for wages and salaries. Those slices of the national income pie vary in size over time.

The slice going to corporate profits, according to the figures that Commerce released on Sept. 28, climbed to 13.6% in the first half of 2006. That's the biggest slice of the income pie going to corporate profits since 1950. In only one year since the Commerce Department started to keep these accounts in 1929 has this slice ever been larger, and that was 1942, when corporate profits accounted for 13.8% of the pie.

This is the stock market's "pie problem." Whatever your take on what the corporate slice of the pie should be, at 13.6% we're clearly near the peak of a 77-year cycle -- excluding the Great Depression years -- that has seen profits range between a 13.8% share of the national income pie and 7.3% (in the not-so-great economy of 1981).

Wages have not been keeping up

A growing economy makes the pie bigger for everyone, workers and corporations alike. But the good times aren't always shared equally.

In the current economic recovery, between 2000 and 2005, the U.S. economy grew by 12% in real terms. (That's after subtracting the effect of inflation.) During those same years, the share of the national income going to corporate profits climbed from 9.3% in 2000 to the current 13.6%, while the share going to wages and salaries fell from 54.9% in 2000 to the current 51.8%. As a result, even as the economy grew by 12%, the median hourly wage rose by just 3%.

More from MSN Money

A sweeter scenario for 2007

The 5 best stocks for 2007

Living wage: How about $9 an hour?

Stagflation: A new peril for stocks

Behind Dow 12,000, an economy at risk

Some economists believe that looking at total compensation, which includes things like health benefits, is a better measure of a worker's slice of the pie than wages alone. But even that wider measure shows a drop from 65.7% of the pie in 2000 to

64.2% this year.

There are a lot of causes for the very sluggish growth of wages and the relatively rapid growth -- from near the bottom of the cycle to near the top -- in the slice of the pie going to corporate profits:

Outsourcing of jobs from the United States to countries with lower labor costs.

Corporate downsizing and restructuring that laid off or fired higher-paid workers first.

Competition with lower-paid workers in an increasingly globalized economy that pressured U.S. workers to accept lower pay in order to preserve their jobs.

Government policies that weakened the bargaining power of labor unions in the United States.

None of these trends has ended, but the pace of change seems to be far more moderate than it was five years ago. So, for example, while union membership was still far lower in 2005 (at 12.5% of the work force) than it was in 1983 (20.1%) or 1990 (16.1%), the decline has slowed. Membership stayed steady at 12.5% in 2004 and 2005, according to the U.S. Department of Labor.

Wages in the huge low-cost labor markets of India and China still lag well behind those in the United States, but wages for skilled workers in India have climbed by 12% to 15% a year, compared with 2% to 6% wage inflation in Western economies.

1 | 2 | next >