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Why Your Best Paycheck May Be Behind You

By Kathleen Murray
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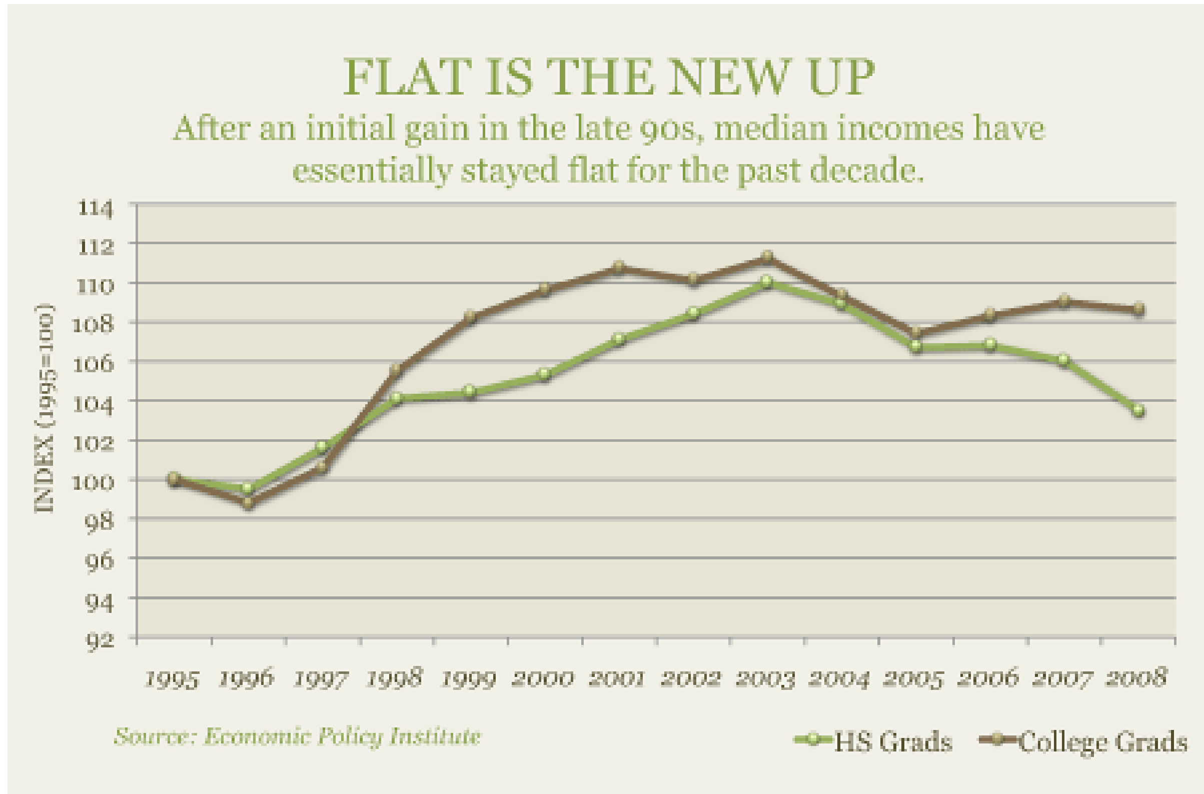
With unemployment numbers starting to look less bad, the stock market holding on to its 2009 gains, and even a recent uptick in the manufacturing and service industries, it's possible to start daydreaming about what seemed like bygone luxuries: a modicum of job security, perhaps a small bonus, maybe even a raise. Indeed, employers are projecting salary increases in the 2.5 percent range for this year.

Don't spend that money just yet. A combination of short-term factors and long-range changes may conspire to squeeze salaries for some time to come. "The stagnant wages we're seeing now — that's just the beginning," says Heidi Shierholz, a labor economist with the Economic Policy Institute. "What's really going to set this period apart is the length of time wages will be falling."

To be sure, your paycheck is affected by many factors, some of them specific to your performance, your company, and your industry. You may very well buck the trend. That said, compensation trends are a lot like gravity: You *can* escape them, but sooner or later there's a good chance you'll fall back to earth.

One of the biggest forces exerting pressure on wages is the job market. Along with the Federal Reserve and a growing number of her peers, Shierholz predicts the U.S. economy will be lucky to get back to pre-recession jobless rates by 2014. In the meantime, high unemployment plus ongoing structural changes and industry shifts will continue to exert downward pressure on paychecks in ways that could be felt well after the jobs picture improves. "The landscape has already changed dramatically for employees," says Ken Abosch, a compensation practice leader with consulting firm Hewitt Associates, Inc. "Base salary increases are not where you're going to accumulate wealth and income."



How did we get to the point where an institution like the annual raise could be in jeopardy? The recession is certainly a major factor — when workers have nowhere else to go, employers are less likely to have to pay a premium to keep them. But other trends tugging at wages have also been in the works for a while:

Real wages have actually been flat for years. Looking back, it turns out a decade's worth of easy credit and faux real estate wealth obscured the fact that incomes for the majority of workers weren't keeping up. After healthy salary growth of roughly 1.8 percent annually from 1995 to 2000, for example, inflation-adjusted, or real, wages for the median worker remained essentially flat from 2000 until 2007 when the recession started, according to government data (average wages increased roughly 2 percent, but that number is skewed by huge gains at the top). In fact, after the recovery in 2002, notes Shierholz, no real wage growth occurred at all for the median worker — despite an increase in productivity of 11 percent over the seven-year time frame.

So who reaped the productivity gains? Typically, companies and their shareholders. Shierholz and other economists attribute the disconnect between wages and output to declining unionization and the need to keep prices low in a competitive global environment.

If wages weren't going up appreciably when workers were in short supply and the economy was growing, it's difficult to see the justification for employers to boost pay when the unemployment rate is in double digits. Until demand for their products and services returns, companies will likely continue to rein in the costs of doing business. And with six unemployed Americans for every open position, that means a buyers' market for employers. Even after the jobs come back — barring policy changes,

extremely low unemployment, or something else to increase employee bargaining power — the gap between productivity and pay is likely to remain a drag on wages.

Entry-level salaries continue to slump. The amount companies are willing to pay to bring new people on board is a bellwether of what's ahead. So the fact that starting salaries were falling before this most recent downturn is ominous. Despite outsized compensation in banking and other high-flying industries, entry-level wages for college graduates declined throughout the previous decade. The average starting salary for a graduate in 2009 was $48,633, according to the National Association of Colleges and Employers, a decrease of 1.2 percent from 2008. From 2000 to 2007, real starting pay for those with bachelor's degrees fell 3.2 percent among men and 1.7 percent among women. In contrast, between 1995 and 2000, real starting pay for college-educated men and women increased 20.9 percent and 11.7 percent, respectively.

While pay in certain in-demand professions such as engineering and accounting continues to edge up slightly, the increases haven't been as significant as in previous years. Till von Wachter, a Columbia University economist who has studied wage fluctuations of entry-level and displaced workers, agrees part of the reductions are driven by cost control, but says it's more than that. In the 1980s, he explains, salaries started going up and many were further inflated by dotcom and financial booms. Now some of that is reversing.

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But can't good workers make up the difference in starting pay when things get better again? Not always, says Lisa B. Kahn, an assistant economics professor at Yale. In a recently published study she found white male graduates who started working during the 1981-82 recession drew starting salaries anywhere from 7 to 20 percent less than their more fortunate peers who had started their careers right before or after them. Even 17 years later, though, they still hadn't caught up, with some trailing those who had graduated in better times by as much as $120,000 over the entire period. "They're often in a job that doesn't give them the training or use their higher skills so that puts them in a worse position when they leave," Kahn says."

New jobs don't pay as well as the old ones. Industry shifts and structural changes in businesses also continue to put pressure on salaries. A 2009 analysis of figures from the U.S. Department of Labor showed that sectors that expanded through this decade have paid an average annual compensation of $55,300, compared with $65,100 for industries that are shrinking. This is partly because many of the newly-created positions are in service industries, which tend to be less organized and have less bargaining power. Think home healthcare and "green" jobs versus auto manufacturing and heavy industry.

The prospects are even worse for people who lose their jobs in a recession. In a recent study of the impact mass layoffs had in the 1982 recession, Columbia's von Wachter found that among the group he studied — men who had been employed for at least three years by their company before getting laid off and with an average age of 40 — less than a quarter ever got back to the level of their previous salary. The majority took pay cuts of 15 to 20 percent, which persisted even 20 years later — bad news for the 15.7 million Americans currently unemployed. Von Wachter attributes this to a number of factors; the former job may have been a perfect fit and difficult to replace, plus companies typically eliminate their best paying jobs first.

What You Can Do

So where does that leave you? The overall picture is undoubtedly bleak, but there are things you can do to prepare for this unwelcome trend:

Rethink your career and investing strategy. With salaries not increasing as steadily, you're probably going to be working longer and switching jobs more frequently to earn more, so planners advise focusing on your "career assets," long a neglected part of many portfolios. The goal is no longer to simply keep working through to retirement, but to continually enhance the value of your skills, whether through a new position, added responsibilities, increased networking, or acquiring additional training or education. This could lead to a relaxation of some of the old rules, such as never withdrawing money from your 401(k) before retirement.

It may, in fact, be OK to tap the retirement account if it's for the purposes of education that will have a longer-term payoff, says Michael Haubrich, a certified financial planner in Racine, Wisconsin."In the old paradigm, it might have been okay to grind your brains out at any old job," counting on pay increases and the markets to help you stumble over the finish line to retirement, Haubrich says. "But that's not going to work anymore."

Continually assess your market value. As with any asset, you need to know what you're worth to employers—and it isn't always what you're paid. By looking at general trends in your industry and what other employers are paying, this benchmarking process will give you a good idea of the direction of your future earnings. Too often, Haubrich says, people don't realize that their skills may be discounted by the marketplace, sometimes significantly.

One of his clients, for example, was surprised to find the going rate for her marketing expertise was half the $250,000 she was being paid. When she was subsequently laid off, however, this knowledge made her much more willing to accept a new position for considerably less than she had been making. "Because she had already done the research, we were able to prepare her so she didn't waste time going after a salary that was unrealistic," Haubrich says.

Adjust your spending and investments as necessary. If you expect your salary stagnation or decline to be short-term, you may be able to weather it by temporarily trimming back your spending. And depending on your other assets, you might not even have to do that. But a longer term or more drastic reduction in pay will likely entail some significant changes, notes Gary Schatsky, a New York-based fee only financial planner. Can you afford your house? Your condo? "I tell clients this is a good time to look at the question of needs versus wants," he says. "You have to prioritize."

For some people, he says, this has meant selling the extra car or taking the kids out of private school. For others, home improvements, dinners out, and expensive vacations have fallen by the wayside. "Renting out vacation homes has become common," Schatsky says. "People are saying that half the summer is dedicated to paying for the next six months." In essence, much of the scaling back that's been forced on us by the Great Recession may well have to become permanent.

While these may not be fun questions to ponder, they are necessary ones as we face a future where steady wage growth is no longer a given. Better to be prepared for them now, than blindsided by them later.

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