THE WALL STREET JOURNAL.
WSJ.com

THE OUTLOOK | August 25, 2013, 4:19 p.m. ET

Stagnant Wages Are Crimping Economic Growth

Employers Seem Wary to Raise Pay

By NEIL SHAH

Bloomberg

Iowa-based sprayer-maker Hagie boosted pay for some specialized skills.

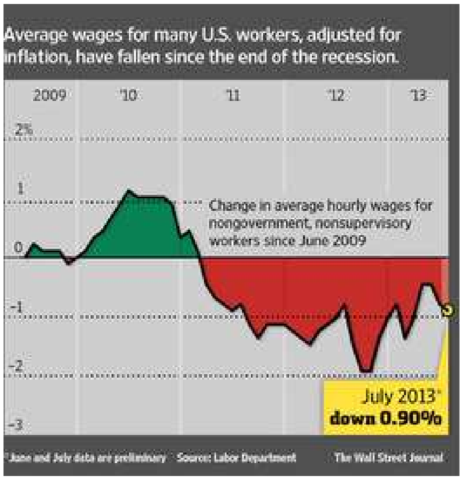
Americans are spending enough to keep the economy rolling, but don't expect them to splurge unless their paychecks start to grow.

Four years into the economic recovery, U.S. workers' pay still isn't even keeping up with inflation. The average hourly pay for a nongovernment, non-supervisory worker, adjusted for price increases, declined to $8.77 last month from $8.85 at the end of the recession in June 2009, Labor Department data show.

Stagnant wages erode the spending power of consumers. That means it is harder for them to make purchases ranging from refrigerators to restaurant meals that account for most of the nation's economic growth.

Economists blame three factors:

Economic growth remains sluggish, advancing at a seasonally adjusted annual pace of less than 2% for three straight quarters—below the prerecession average of 3.5%. That effectively has put a lid on inflation, which has been near or below the 2% level the Federal Reserve considers healthy for the economy. With demand for labor low, prices not rising fast and 11.5 million unemployed searching for work, employers aren't under pressure to raise wages to retain or attract workers.



Businesses are changing how they manage payrolls. Economists at the Federal Reserve Bank of San Francisco in a recent paper said that, in the past, companies cut wages when the economy struggled and raised them amid expansions. But in the past three recessions since 1986—and especially the 2007-2009 downturn—companies minimized wage cuts and instead let workers go to keep remaining workers happy. As a result, to compensate for the wage cuts that never were made, businesses now may be capping wage growth. "As the economy recovers, pent-up wage cuts will probably continue to slow wage growth long after the unemployment rate has returned to more normal levels," the researchers said.

Globalization continues to pressure wages. Thanks to new technologies, Americans are increasingly competing with workers world-wide. "We are on a long-term adjustment, as China, in particular, but all developing countries, get their wages closer to ours," said Richard Freeman, an economist at Harvard University. According to Boston Consulting Group, there will be only a roughly 10% cost difference between the U.S. and China in making products such as machinery, furniture and plastics by 2015.

The upshot: Even though rising home prices and stock values are making some people optimistic, many workers can't push for higher pay—crimping their spending and potentially the recovery. "Workers feel like they have absolutely no bargaining power," said Robert Mellman, an economist at J.P. Morgan Chase & Co.

Besides not feeling confident enough to demand higher wages, employees also are wary of going out and looking for better jobs. Only 1.6% of employed Americans quit their jobs in June, below the roughly 2%-2.2% prerecession level. People tend to quit jobs more readily when they are confident they will find a new one that's equal or better.

The only path to wage gains is through a stronger economy or an increase in demand for specialized skills.

Hagie Manufacturing Co., a Clarion, Iowa, maker of crop-protection equipment, overhauled its pay system recently to reward employees with skills like welding and engineering. For instance, the average hourly wage for Hagie's welders was boosted to $15.50 from $13.50. The 480-person company, which has benefited from a strong farm economy, is looking to hire over 40 people this year.

To be sure, wages in some sectors have increased. Adjusted for inflation, nonsupervisory workers in education and health services have seen their pay rise 0.9% since June 2009. But the outlook for pay increases in many other sectors remains grim. Restaurant workers' average pay has dropped 2.7% since the recession's end; manufacturing workers, 3.1%.

Americans are spending enough to keep the economy rolling, but don't expect them to splurge unless their paychecks start to grow. Neil Shah reports on the News Hub. Photo: Getty Images.

Related Article

American Incomes Face Tough Slog Over Next Few Decades

"There are shortages, but [auto] companies aren't raising salaries to get people," said Sean McAlinden, chief economist at the Center for Automotive Research, a not-for-profit think tank. America's car industry has undergone a major overhaul of its compensation system. As a result, new employees receive pay that can be around 50% less than older workers, he said.

All told, Patrick Newport, an economist at IHS Global Insight, expects real wage growth of only 1% by the end of 2014. That is "good news for employers," he said, "not-so-good news for workers."

The long-term picture also isn't encouraging. In a study published Monday, Cornell University economist Richard Burkhauser notes that demographic trends such as the aging of the American population will "drag down median income over the next two decades." ("Income" includes wages but also things like stock-market returns.) After supporting the economy during their peak earning years, Baby Boomers are retiring, which means many of them will stop working and shift to living off smaller incomes, Mr. Burkhauser said. That will help reduce growth in median incomes by about 0.5% per year through 2030, he says—considerably weaker than the already lackluster 1.5% to 2% growth over the past decade.

Consumers remain the biggest driver of the U.S. economy, but without more money coming in, it will be difficult for them to spur robust growth.

Write to Neil Shah at neil.shah@dowjones.com

A version of this article appeared August 26, 2013, on page A2 in the U.S. edition of The Wall Street Journal, with the headline: Stagnant Wages Crimping Economic Growth.