

EPI BRIEFING PAPER

ECONOMIC POLICY INSTITUTE • SEPTEMBER 7, 2009 • BRIEFING PAPER #240

THE RECESSION'S HIDDEN COSTS Workers lucky enough to keep their jobs still feel the pain in their paycheck

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The workers who have retained their jobs in this recession have not escaped unscathed. The first part of 2009 has witnessed a collapse of hourly wage growth for American workers that is both wide and deep. What will the rest of 2009 and beyond look like for these workers and their families? First, workers who are still employed are seeing a decline in living standards as a result of this collapse in wages. Although the recovery package induced the end of the broader economic decline, unemployment is expected to remain high and continue to put downward pressure on wages across all income groups for several years to come. The downturn in living standards during this recession will only compound the erosion of incomes that occurred over the 2000-07 business cycle—the only one on record in which a typical working family had less income at the end of the cycle than at the beginning. Moreover, employed workers are seeing other cutbacks in the form of involuntary paid leaves (furloughs) and suspended contributions to 401(k)s as a direct result of the recession.

Another reason to be concerned about the implosion of wage growth is that it will be a drag on the recovery. Wage growth is central to the growth of household consumption. That consumption is required if we are going to lift the demand of goods and services, a demand that is essential for a robust recovery. As it is, the severe loss of wealth has caused consumers to scale back their consumption, which in turn has caused businesses to scale back investments and employment. Making matters worse, the expectation that household savings rates will continue to rise—as households lower their debt levels—will mean that consumption will increase more slowly relative to incomes in the period ahead.

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Various macroeconomic forecasters have recently been highlighting this issue. For instance, Jan Hatzius of Goldman-Sachs wrote on August 5 that “the weakness in household income will make it harder to raise saving without significant constraints on consumption. One key issue is the sharp slowdown in hourly wage growth, which has fallen from around 4% (annualized) in 2006-08 to just 0.7% over the past three months” (Hatzius 2009). He further noted that the lowering of household income growth (inflation-adjusted) by 1% is equivalent to “deterioration in nonfarm payroll changes by about 300,000 per month.” It might be noted that a 300,000 per month change in employment is larger than the much remarked upon and beneficial slowdown of job losses in recent months. Wage growth has already slowed considerably, but continued high unemployment can be expected to push wage growth down even further. Another forecaster, Joseph Brusuelas, director of Moody’s Economy.com, expressed concern about future wage growth as well: “But if you look beyond the third quarter, where is consumption going to come from? Wages and salaries are not there” (Torres 2009).

This report examines nominal (not inflation-adjusted) hourly wage trends and shows a remarkable slowdown. Chief among these findings:

- Private-sector wages have grown at a 1.3% annual rate over the last six months, less than 40% as fast as the growth over 2007 and the first half of 2008, and a third slower than wage growth in late 2008.
- The wage slowdown was even greater among managerial and professional workers, where wages grew at a 1.1% annual rate, which was half of that in late 2008, and less than a third of the growth over 2007 and the first half of 2008.
- The hourly earnings of production and nonsupervisory workers, representing over 80% of employment, grew at a steady 4% throughout 2007 and 2008, but then collapsed to a 1.4% growth rate in 2009 so far.
- Wage growth among all workers, public and private, over the last year was just about half as strong as wage growth over the two prior years.

- Among women, wages grew 1.7% over the last year, more slowly than the 2.9% growth among men. The deceleration of wage growth among women was sharp—with wages growing at a rate 57% slower than in the prior years.
- Wage deceleration has occurred across the educational spectrum, among both high school and college graduates.
- Surprisingly, wages for college graduates have decelerated more rapidly, with wages growing at a rate 56% slower than in the prior two years and growing more slowly than for other workers. The falloff in college graduate wages seems to be driven by the total collapse of wage growth among women college graduates, whose wages grew at a measly 0.3% over the last year.
- The wage slowdown was greater among women throughout the wage ladder, with the greatest slowdown among middle-wage women (whose wages grew at a 0.6% rate in the last year, 87% slower than in the two prior years).
- Wage growth also slowed among men but only slightly so among high-wage men.
- Anecdotal and some survey evidence show that employers are imposing involuntary and unpaid furloughs. Two consulting firms report in surveys that 17% of firms have imposed furloughs. This is an additional way that the recession has adversely affected employed workers.
- More than 20% of firms have suspended their contributions to 401(k) and similar pension plans.
- In recent consumer surveys, the lowest percentage of consumers reported income gains in the survey’s 60-year history, and a majority of respondents reported a worsening of personal finances.

Trends in private-sector wage growth

There are only two published statistical series that provide up-to-date readings on wage trends at the national

TABLE 1

Private sector wage growth, 2007-09

Private sector wages and salaries (ECI)	Six-month annualized growth rates				
	2007		2008		2009
	June	Dec	June	Dec	June
<i>All private</i>	3.7%	2.9%	3.4%	1.9%	1.3%
Management, professional	4.3	2.7	4.0	2.2	1.1
Natural res, construction, maintence	3.3	3.8	3.6	2.8	0.9
Transportation and material moving	2.9	2.5	3.8	1.7	1.7
Private hourly earnings, production/nonsuperv.	4.1%	3.4%	3.8%	4.0%	1.4%
Memo:					
Inflation	3.9%	4.3%	5.5%	-5.4%	2.9%
Inflation, excluding food and energy	2.3	2.5	2.3	1.2	2.3

SOURCE: Authors' analysis of BLS Employment Cost Index series.

level: the Employment Cost Index (ECI), and the hourly earnings of production/nonsupervisory workers series reported by the Bureau of Labor Statistics in its monthly report on establishment payroll data. **Table 1** shows the annualized growth rate of private-sector wages from these series for six-month periods back to the beginning of 2007. The table presents the ECI wage series for three different occupational groupings in order to examine the breadth of wage deceleration. These series show that hourly wage growth over the last six months has been much slower than wage growth in 2007 and 2008, including the last half of 2008 when wage growth started to subside according to the ECI series. For instance, ECI private-sector wage growth (Table 1 and **Figure A**) had sunk to a 1.3% annual rate in early 2009, less than 40% as fast as the growth over the 2007 and early 2008 period. The slowdown was even greater among managerial and professional workers, where wages grew at a 1.1% rate, which was half the rate in late 2008 and less than a third of the growth of 2007 and early 2008.

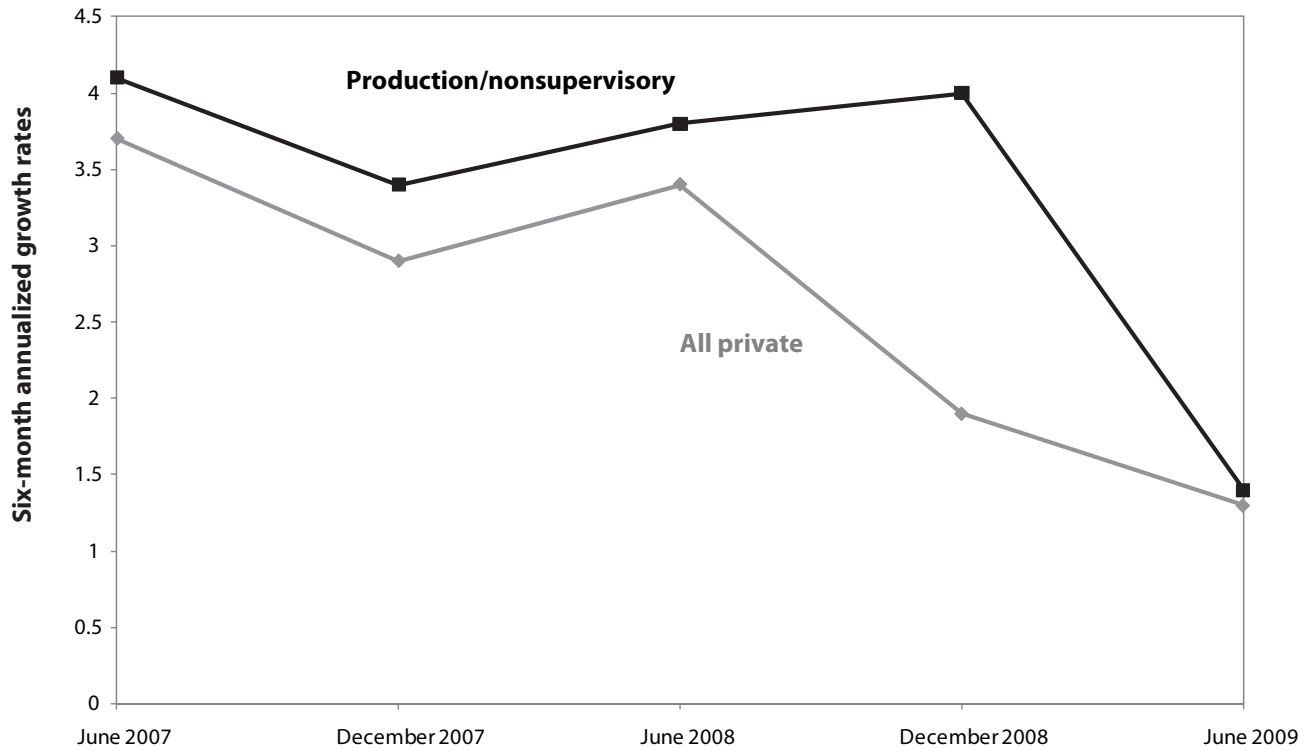
The production worker/nonsupervisory hourly earnings series, which covers more than 80% of payroll

employment, suggests that wage growth held to a steady 4% annual growth rate throughout 2007 and 2008, but then collapsed into a 1.4% rate of growth (mirroring the ECI rate) in the first half of 2009 (Figure A). This is a remarkable collapse of wage growth that affirms what is seen in the ECI series.

Some of the wage deceleration might be a response to the slowdown in inflation, as energy prices fell from their high values in mid-2008. As the bottom panel in Table 1 shows, overall inflation actually declined at a 5.4% annual rate in the latter part of 2008. However, inflation has resumed in 2009 and is now running at 2.9%, a rate that is far in excess of the wage growth in any of the data series and for any occupational group. This means that the wage deceleration is leading to a fall in wages, after adjusting for inflation, and thus driving family incomes lower. The bottom panel of Table 1 also lists the measure of 'core' inflation, which excludes the more volatile food and energy expenditures. Core inflation has been pretty steady in the low 2% range for a few years. Wage growth is now substantially below the growth of core inflation as well.

FIGURE A

Private-sector wage growth, 2007-09



SOURCE: Authors' analysis of BLS Employment Cost Index series.

Wage deceleration by wage and education levels

This section further examines wage deceleration by examining trends by gender, education, and wage level. These trends are calculated from the Outgoing Rotation Group files of the Current Population Survey (see Appendix B in Mishel et al. 2009 for details), the household survey that provides the measure of unemployment each month. These data reflect the wages and salaries of all wage and salary workers, both private and public sector. Because these data are not seasonally adjusted we cannot compare wage levels of the recent six-month period to the prior six-month period. Therefore, we make comparisons of the most recent six-month period to the same period a year earlier (and do so for several years). So, the tradeoff for obtaining detailed wage trends by wage and education level is that we have to look at wage growth over the last year—the first half of 2009 versus the first half of

2008—and compare to the wage growth of comparable periods in two prior years.

Table 2 confirms our earlier findings of substantial wage deceleration, though to a lesser degree—presumably because the trends in Table 2 cover a longer period, including both the sharp deceleration of the last six months and the less sharp deceleration of the prior six months (the last half of 2008). Table 2 is also able to breakdown the wage data along gender lines. The data show that wage growth among all workers over the last year was just about half as strong as the wage growth over the two prior years, but among women the deceleration was even sharper—with wages growing at a rate 57% slower than in the prior years. Women's wages also grew slowly in absolute terms, rising at just 1.7% over the last year compared to the 2.9% growth rate among men. That women's wages have been more affected by the recession is surprising given the sharper rise of unemployment among

men than women. It may be that the larger increase in unemployment among men has what we call a “composition effect”—those who became unemployed were more likely to have had lower wages, thus statistically boosting the observed wages of those who remained employed. Wage deceleration has occurred across the educational spectrum, as can be seen by the sharp deceleration in wages among both high school and college graduates (measured

as those with a four-year college degree but no further education). Perhaps surprisingly, wages for college graduates have decelerated more, with wages growing at a rate 56% slower than in the prior two years and growing more slowly than other workers. The fall-off in college-graduate wages seems to be driven by the total collapse of wage growth among women college graduates, whose wages grew at a measly 0.3% over the last year.

TABLE 2

Wage growth by gender, education, and wage level, first half 2006-09

	First half:			Wage
	2006-07	2007-08	2008-09	slowdown (%)*
By education				
All	4.1%	4.3%	2.2%	48%
High school	3.4	3.3	2.0	41
College	3.5	3.2	1.5	56
Men				
High school	2.9	3.5	1.4	56
College	5.1	2.7	2.7	30
Women				
High school	4.2	2.7	3.3	5%
College	1.2	4.1	0.3	89
By wage level**				
Men				
Low	1.9%	1.7%	1.1%	39%
Middle	5.0	3.2	2.8	31
High	2.8	5.2	3.3	18
Women				
Low	2.9%	3.8%	1.5%	55%
Middle	3.1	6.0	0.6	87
High	5.3	3.3	1.5	65
Memo:				
Inflation, all	2.5%	4.2%	-0.6%	118%
Inflation, 'core'***	2.4	2.3	1.8	26

* Growth in last year relative to the average of prior two years.

** Wages corresponding to the 20th, 50th, and 90th percentile wages.

*** Inflation, except food and energy.

SOURCE: Authors' analysis of CPS ORG data.

When we look at trends by wage levels, we find that the wage slowdown was greater among women throughout the wage ladder, with the greatest slowdown among middle-wage women (whose wages grew at a 0.6% rate in the last year, 87% slower than in the two prior years). Wage growth also slowed among men but only slightly so among high-wage men.

Real wages

The growth of inflation-adjusted wages has been disappointing for most of the last 30 years, except in the late 1990s (Mishel et al. 2009). The recent recovery from 2002 to 2007 was particularly disappointing, as inflation-adjusted wages (or compensation, including benefits) failed to grow for either high school or college educated workers or for the median, or typical worker.

Assessing the trend in inflation-adjusted wages in this downturn is complicated because inflation has been particularly volatile, driven by large fluctuations in energy prices throughout 2008 (as seen in Table 1). By one measure (the ECI series on private-sector wages) there has been no growth in inflation-adjusted wages between December 2006 and June 2009. However, by another measure the inflation-adjusted hourly earnings of production/nonsupervisory workers advanced 2.9% over this same period. Some of the difference between these two series could be that the hourly earnings series is subject to a composition effect (when lower-wage worker employment shrinks relative to that of higher-wage workers, the *average* wage gets statistically boosted even though wage rates overall have not actually risen). The ECI series is less subject to a composition effect since the index is weighted by an earlier period's occupation and industry mix and so composition is relatively fixed. The differences between these two series (see Table 1) is most pronounced in the last half of 2008, the period of most rapid employment decline, suggesting that composition effects may be distorting the hourly earnings series as a measure of wage rate trends: hourly earnings grew 4.0% but ECI wages just 1.9%.

It is interesting to note that both wage series show wage growth lagging behind inflation over the first six months of 2009. Unfortunately, erosion of inflation-adjusted wages is likely to continue going forward. Wage growth can be

expected to be even less than it has been recently (some forecasts even seem to suggest that nominal wages will fall), which is already below a 1.5% annual rate of growth. Meanwhile, inflation will likely be below 2.0% for the next year or so but still be greater than wage growth.

Furloughs

Another way that employed workers are feeling the brunt of the recession is through furloughs, involuntary unpaid leaves mandated by their employers. Such actions may also constrain consumption growth in the recovery because every week on furlough is the rough equivalent of a 2% cut in annual pay. Companies such as the recreational vehicle manufacturer Winnebago, the state of California, and the University of Arizona have all implemented furloughs during the current recession, and although evidence of their increasing use is widespread, there are no official government statistics tracking the number of workers on furlough.

The Bureau of Labor Statistics keeps a number of data series that provide rough evidence of increased furloughs. The average weekly hours of production workers—the average amount of time a worker works in a week—has been roughly 33 hours a week in the last few months. That is the shortest work week since the government began tracking it in 1964. In addition to average weekly hours worked, the number of workers who involuntarily work part time due to “slack work or business conditions” has now reached 6.8 million, more than double the number in December 2007. These are workers who were full-time employees but whose hours were cut to part time (less than 35 hours a week) due to economic conditions.

Other recent surveys provide more direct evidence of the increasing prevalence of furloughs as a cost-cutting measure. A recent survey by the human resources consulting firm Watson Wyatt found that 17% of surveyed firms had already implemented some sort of mandatory furlough and another 4% expect to do so in the next year (Watson Wyatt Worldwide 2009). This is roughly in line with a similar survey from Towers Perrin (2009), which also found that 17% of firms surveyed had decided to use furloughs to reduce costs. Thus, even amid skyrocketing unemployment, workers who still have jobs are working less and less.

Faltering pensions

Another way in which worker pay is taking a hit not captured in wage data is the decision of many employers to curtail expenses by not contributing to employee defined-contribution retirement plans, such as 401(k)s. In these plans employers do not guarantee benefits upon retirement: rather, employees obtain the value of whatever was accrued in their accounts. Therefore, unless employers later make up for contributions not made during the recession, retirement income will be reduced.

Due to the timing of accurate data collection, it is hard to track the prevalence of firms suspending their 401(k) contributions. Detailed data for a particular time period are released a year or two later, which means current data will not reflect the losses suffered by workers during the current recession. The Pension Rights Center keeps a list of companies that have suspended their 401(k) contributions, and their list paints a telling picture. PBS, Ford, Eastman Kodak, and American Express are some of the iconic American companies that find themselves on the early August 2009 list of roughly 300 firms who have suspended retirement contributions.

The data pointing to increased suspension of 401(k) plans are not just anecdotal. A number of firms have also conducted surveys which confirm that more and more companies are suspending their 401(k) contributions, further straining workers in this recession. In a survey of 283 U.S. companies in April of this year, the consulting firm Grant Thornton found that 22% of the companies surveyed had already or will reduce or eliminate their 401(k) match (Gross and Ritter 2009). This number is in line with a CFO Research Services' report, which found that 23% of companies surveyed had suspended or intend to suspend their match (CFO Research Services 2009).

Consumer confidence

Given the current high unemployment and the expected slow recovery it is not surprising that consumers have a dim view of their finances and of expectations for the months ahead. The University of Michigan Consumer Sentiment Survey, a respected and widely used survey of consumer confidence, has shown increases in confidence over the last four months, reflecting the slowing decline in jobs and the economy overall. This is a positive

development. While the index appears to show a recovery in consumer sentiment, it still remains 13% below what it was at the start of the recession in December 2007. More alarmingly, the share of consumers reporting income gains was the smallest on record in the 60-year history of the survey, and a majority of respondents reported a worsening of personal finances (Hoyt 2009).

The Conference Board survey of consumer confidence showed almost all of their indexes weakening in July 2009, but most remained higher than at the beginning of the year. The current and expected overall consumer confidence index declined for the second straight month in July 2009. However, expectations of consumer sentiment are 33% higher than in January 2009. Unfortunately, employment expectations remain grim and are getting worse: 48% of respondents believed that jobs are hard to get—the third straight monthly increase. Moreover, just 3.6% of respondents believed that jobs were plentiful, which is half as many as in January 2009.¹ It is apparent that concerns over employment and continued income losses will continue to dampen consumer confidence and the prospects for a robust recovery.

Conclusion

Hourly wage growth has slowed considerably for the broad array of workers, including high school and college-educated workers and for high-, middle-, and low-wage workers. The breadth of the wage slowdown guarantees that income growth and the corresponding consumption growth will also slow down considerably. The impact of involuntary furloughs and other work hour reductions will compound the impact of the wage slowdown and further constrain household consumption growth. The deleveraging of households—paying off debts and increasing savings—will also make for a more sluggish recovery in consumption relative to other cycles. These dynamics, in turn, will result in less business investment as businesses see less need to expand capacity to satisfy consumer demand. The likely scenario, all things considered, is for a recovery that is not as robust as one would wish it could be. Not surprisingly, forecasters anticipate continued employment losses well into 2010 and for unemployment to keep rising for another nine to 15 months.

This situation raises two policy concerns. One is the need to generate faster job growth to obtain a robust recovery. Given that household consumption and business investment cannot be expected to fuel a rapid growth in the demand for goods and services, it will require further government actions to do so. These could include everything from tax credits aimed at subsidizing the creation of new jobs to further fiscal relief to the states, which would preserve jobs both in state and local governments (and also in firms providing goods and services to state and local governments). More supports to adversely affected families would not only help people weather this severe downturn, it will also boost spending.

A second policy concern is the long-term disconnect between wages and productivity, of which the recent collapse in wage growth is a symptom. Earlier research (Mishel et al. 2009) has established that the wages of both high school and college-educated workers did not grow at all over the 2002-07 recovery even though productivity grew rapidly. This was a stronger version of a phenomenon evident for roughly 30 years: The continuing inability of workers to see their wages and living standards closely linked to improved productivity, whether in recession or not. Such a trend is a recipe for continuing stagnant incomes and further growth in income inequalities.

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Endnotes

1. Numbers from the University of Michigan/Reuters Consumer Sentiment Survey and The Conference Board Survey of Consumer Confidence were obtained from economy.com.