CPA
Practice Advisor

one Americans probably care about most: Pay.

Sep. 12, 2014

WASHINGTON (AP) — The U.S. job market has steadily improved by pretty much

Just why pay has been so weak and when it might strengthen are key issues for the Federal Reserve in deciding when to raise interest rates.

The trend has mystified analysts.

"This is the primary economic and policy puzzle facing policymakers right now: Why have wages remained so low in the face of an improving economy?" said Joe Brusuelas, chief economist at McGladrey, a tax and accounting firm.

Some economists expect pay to pick up eventually as the job market keeps improving. They think wages have lagged because millions of people are still out of work — many of whom aren't counted in the unemployment rate because they're no longer looking for a job.

But others say they fear that pay has stagnated because of trends that will persist even after the economy has moved closer to full health.

They note that companies have been making more use of temporary and part-time workers, usually at lower pay, to replace full-time permanent jobs. And newer technologies have enabled businesses to produce more with fewer employees.

A survey of Harvard Business School graduates released Monday lends weight to that notion. Nearly half the respondents said they'd rather invest in technology than in workers. Just over 40 percent expect wages and benefits to decline over the next three years.

Economists are flummoxed by the way the historical relationship between pay and unemployment has eroded since the recession ended. Based on historical trends, the steady drop in unemployment should have raised inflation-adjusted wages by 3.6 percent by June, according to researchers at the Federal Reserve Bank of Chicago.

That’s because employers have had to fill jobs from a smaller pool of unemployed

By contrast, wages are up just 1.5 percent for employees in education and health care.

So why has overall wage growth been so weak? Economists point to several factors.

The biggest is that there are still too many people desperate for work than is typical for a healthy economy. That makes it easier for employers to fill jobs without raising pay.

There are 227,000 fewer people with jobs than in November 2007, just before the recession began. Yet the working-age population is up 15.3 million since then. That’s kept the number of unemployed elevated: 9.6 million Americans, up from 7.6 million when the recession began.

But it’s not just unemployment that’s holding down wages. The many part-timers who would prefer full-time work are also competing with those who are out of work. There are 7.2 million involuntary part-timers, up from just 4.6 million in late 2007.

Half the economists surveyed by The Associated Press last month cited the high number of people without full-time jobs as the main reason wage growth has been weak.

The Chicago Fed estimates that if all measures of unemployment, including involuntary part-timers, had returned to pre-recession levels, paychecks after inflation would now be rising up to 1 percentage point faster.

Given these trends, people who do have jobs have less leverage to demand higher pay. Sixteen percent of working Americans say their pay hasn’t budged in the past year, up from 11 percent before the recession, according to research by Bank of America Merrill Lynch.

In a healthier economy, more people would seek higher pay elsewhere and quit their jobs once they found it. But the number who quit their jobs tumbled during the recession and has only partly recovered.

But churn has declined by up to one-third since the early 1990s, according to research by economists Steven Davis and John Haltiwanger.

Typically, wages also rise in line with increased productivity. Productivity measures output per hour of work, and higher productivity enables companies to pay more without sparking inflation. Yet productivity has been unusually sluggish the past three years.

Some economists are surprised that the recession didn’t weaken Americans’ pay even more than it did. So deep was the recession that many analysts assumed companies would reduce not only jobs but also wages.

The lack of pay cuts during the recession may help explain meager raises now. Having paid more than they typically would during the downturn, companies may now try to make up for lost ground by holding off on raises longer than usual.

All these trends make it particularly hard for economists to predict when, or even whether, wages will finally accelerate.

With unemployment declining and other gauges, such as the number of quits and involuntary part-timers, also improving, some economists think pay gains will accelerate by mid-2015.

“I do think we’re setting the stage for an eventual turn higher in wages,” says Michelle Meyer, an economist at Bank of America Merrill Lynch.

—