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THIS ISSUE

FROM THE MAGAZINE

BUSINESS

Where Did My Raise Go?

Shrinking paychecks are the new reality for many Americans. How global markets and a weak economy are affecting how we work—and how much we make

By [DANIEL KADLEC](#)



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Tod Raphaely was flying high four years ago when he was named European sales manager for Raltron Electronics and saw his salary rise to \$115,000 a year. Raphaely, now 43, remained upbeat when the tech bubble began to leak air and he was reassigned to the Miami headquarters of the manufacturer of computer and cell-phone parts. He and his wife Wendy bought a condo and renovated the kitchen. He didn't panic when he and several other Raltron employees had their pay cut 10% in the fall of 2001 and another 10% the following spring. "We were hoping things would get better," Tod says. "So we continued to trudge on." But last fall Raltron slashed wages a third time—by more than 20% in Tod's case. He now makes \$70,000 a year even though he has taken on additional duties. He and Wendy have cut household spending, but their credit-card debt—and their anxiety—is soaring. Tod says he is grateful just to have a regular

paycheck.

Everyone knows about unemployment. But millions of working Americans are now facing a less familiar and perhaps more troubling problem: shrinking wages. It's a phenomenon that takes many forms. Some workers, like Raphaely, have had to swallow outright pay cuts. Others have lost their jobs and, in the tough labor market of today, have had to settle for new ones at less pay. Still others—including employees at such giants as AT&T, Boise Cascade and Starwood Hotels—have had to accept pay freezes that, when rising prices are factored in, amount to reduced compensation. To add insult to injury, companies everywhere are reducing bonuses and overtime and eroding health and pension benefits.

The numbers are grim. For the 500,000 workers laid off since January, the average job search has stretched to a 19-year high of nearly five months—about twice the duration of the typical severance package. According to outplacement firm Challenger, Gray & Christmas, 17% of those who do find work—nearly double the historical percentage—are settling for less pay. The net result of the various pressures on pay: in the first three months of 2003, median weekly earnings adjusted for inflation fell 1.5%, according to the U.S. Labor Department. That's the biggest drop since 1991, according to Jared Bernstein, an economist at the Economic Policy Institute, a research group based in Washington. Wage erosion partly explains why the Federal Reserve Board openly frets about the threat of deflation, a downward spiral in prices that can cripple an economy by making debt repayment more difficult and encouraging consumers to wait for even lower prices. Adding fuel to the deflation debate, the cost of goods to both consumers and manufacturers fell in April, officials reported last week.

The no-raise economy is partly a predictable, temporary aftershock from the burst Internet bubble and recession. With core inflation (excluding food and energy) officially running at just 1.5%, workers are relatively well equipped to cope with stingy employers—particularly in an era of 0% auto financing and mortgage rates that last week dropped yet again to historic lows. Dramatically declining energy prices since the Iraq war ended are another welcome buffer, allowing consumers to keep more of what they earn. But there is an unsettling permanence to the falling-wage trend, as companies hold the line on

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compensation so they can compete in an increasingly global economy in which low costs are key to survival. The ugly truth, which you won't hear on the campaign trail, is that even as economic growth picks up—as it surely will—there isn't a lot Washington can do to encourage employers to hand out more raises.

Cost pressures will be so intense during the next expansion, business experts say, that companies are likely to stick to their guns. They will outsource more work—including skilled and white-collar tasks—to cheaper labor markets. They will embrace pay-for-performance schemes, which generally reward only the top-ranked workers at each wage level. And they will shift more of the costs and risks of illness and retirement to workers, especially in steel and other heavy industries.

Consider Jacki Harris, who through no fault of her own makes 25% less than she did a few years ago. With overtime, Harris, 41, was making \$59,000 a year for delivering airplane parts and keeping track of blueprints at a Boeing jet plant in Long Beach, Calif. She was relieved to keep her job through several rounds of layoffs. But as the ranks thinned, she lost her seniority edge and ended up as a clerk making \$44,000 a year with no possibility of overtime. "I cried for a month," says Harris, a single parent with a 13-year-old son.

"You do more with fewer people. They push and push." She is struggling with her mortgage, clipping grocery coupons and living in fear of losing her job. Says Harris: "I never miss a day of work." Ron Kimball is also working for less pay. Two years ago, he was a computer-sales executive earning \$130,000 a year. He leased two shining cars, ate out often and took expensive vacations with his wife. When the small computer-services company he worked for in Raleigh, N.C., went out of business in the summer of 2001, Kimball, now 58, was unconcerned. "I had never had a problem finding work," he recalls. But times had changed. He struggled to land a decent job, and the stress contributed to a heart condition that required surgery. Finally, a mortgage firm that had turned down Kimball for a loan-officer opening asked him to manage its website. He jumped at the offer. His new annual salary: \$40,000.

It's not just factory workers and those in the beleaguered tech industry who are taking their lumps. Steve Doppelt, 36, is an

advertising creative director in New York City. With his employer, Publicis Groupe, in the throes of a major shake-up, Doppelt last month left to take a similar job at Kirshenbaum Bond + Partners—for 10% less pay. O.K., he isn't starving. The new job pays more than \$200,000 a year, and Doppelt is regarded as a rising star. But he no longer has a secretary, and he is working in a cubicle instead of an office and is investing less for his later years. Doppelt's plight is reflected in an unusual statistic: even among the top 10% of earners 25 and older, average earnings adjusted for inflation dropped 1.4% in the first quarter of 2003 from the same period last year, according to the Labor Department. At the other end of the spectrum, wages for young college grads fell 1.5% in 2002, reports the Economic Policy Institute.

One job title defying the trend is ceo: pay for chief executives rose 15% in 2002, according to Equilar, a firm that studies ceo compensation. That amounts to about 200 times the pay of the average worker, up from 56 times in 1989, according to the Journal of Economic Issues. Nowhere is this disparity starker than in the audacious pension guarantees and bonuses proposed for top executives at struggling AMR, parent of American Airlines. The carrier recently asked the unions representing its machinists, flight attendants and pilots for \$9 billion in wage givebacks and other concessions over five years to keep the jets flying. Captain Mike Leone, a veteran pilot, took a 23% pay cut and has canceled plans to buy a new house. "We're just glad to have a job," says Leone.

Meanwhile, the brass at AMR quietly landed pension guarantees worth \$41 million—benefits that, unlike those of the workers, will be protected even if AMR goes bankrupt. Succumbing to public pressure, AMR backed off on another issue: its proposed "retention" bonuses for top executives. A flap over that cost ceo Donald Carty his job. But the executive pensions remain in place. Investing legend Warren Buffett, who has been campaigning against executive compensation that is out of line with returns to workers and shareholders, said in a recent speech that "what really gets to the public is when ceos get rich, really rich, and they get poorer."

Pay freezes and cuts in one company or industry are a necessary feature of healthy competition, but when they spread through an entire economy, it is cause for concern. Federal Reserve

Chairman Alan Greenspan recently signaled that he was prepared to cut short-term interest rates for the 13th time since January 2001 to guard against a corrosive bout of deflation, like the one Japan has endured for nearly a decade. Wage pressures and deflation "obviously go together," says Laurence Meyer, an economist and a former member of the Fed's board of governors. "When there is slackness in the economy, it puts downward pressure on wages that then passes through to the price of goods and services."

To understand what this means in human terms, think back to Tod Raphaely, the electronics executive. With his pay slashed a total of 40%, he and his wife have stopped all leisure travel, including their annual Christmas trip to visit family in New Jersey and Pennsylvania. The Raphaelys, who have no children, have one extravagance. They feed their cats jarred baby food. But they no longer buy the CDs and DVDs they love. Such scrimping means less revenue for all sorts of businesses, which then face pressure to fire workers or cut wages. And so the cycle continues. Thanks to the pay cuts, Raltron "is back on the upswing," says owner Alexander Wolloch. But he doesn't know when he will be able to restore the old salaries.

President Bush's proposed solution is a package of tax cuts mainly for upper-income Americans. The current "recession mentality," he argues, has led to extensive corporate cost cutting and downward wage pressures that will abate as the economy revives. "When demand goes up, wages will follow," Bush says. No doubt faster growth, when it comes, will help boost employment and stabilize pay. But it is unlikely that wages will rebound quickly. The world has changed. The spread of technology and skills, of Internet communication and cheap shipping, means that today more U.S. firms must compete against foreign rivals that are more formidable than ever. And this requires holding down wages.

RACE TO THE BOTTOM

Over the past year, steelworker Eugene (Lou) Costello has endured pay cuts of 15%, 10% and 12.8%, plunging his annual base pay from about \$50,000 down to about \$33,000. "I feel like a marathon runner who sees the finish line but when he gets close, his coach holds up a sign that says he has 25 more miles to go," says Costello, 61, who works for Wheeling Pittsburgh Steel in Mingo Junction, Ohio. "I'm going to have to work until I die."

Costello chose to work in steel mills rather than the coal mines where his father toiled because he believed steel jobs were more secure. Now he is scrapping plans to build a long-planned retirement house and says he will not be replacing his 13-year-old pickup truck anytime soon. "You have to make choices," he says, "between a house payment, a car payment or medicine."

Costello is the human face of a dramatically changed industry. With about 30 steel firms operating under bankruptcy protection, the steelworkers' union has willingly taken part in a vast restructuring of pay and benefits spearheaded by New York City investor Wilbur Ross. His International Steel Group (ISG) recently completed its third major acquisition in two years, buying most of the assets of bankrupt Bethlehem Steel. Ross warns of more wage pressure ahead: "If we don't reform our labor system very soon, we won't have a manufacturing sector to worry about." He is taking aim at work rules that prevent union steelworkers from performing as efficiently as foreign competitors or nonunion rivals at U.S. mini-mills.

Make no mistake: the reform of which Ross speaks means employees will be working harder for fewer benefits. Bethlehem Steel, along with Acme Steel and LTV before it, off-loaded a total of \$8 billion in pension obligations to the federal Pension Benefit Guaranty Corporation before Ross acquired it. He then wiped out health-care benefits that had been promised to retirees. For current workers, he installed co-pays and coverage limits where there were none before and replaced the union's defined-benefit pension plan with a less secure defined-contribution plan.

In return, thousands of laid-off workers were recalled at their old hourly rate. If they meet specific production targets, they get a bonus every two weeks. The system is working: ISG is now among the world's most efficient manufacturers of flat rolled steel for cars and appliances, producing it for about \$348 a ton shipped—about 25% cheaper than French and Japanese steel. In the last six months of 2002, steelworkers at LTV collected average bonuses equal to seven weeks' pay. Now Ross is looking at union rules and wages in the tire and auto industries—both, in his view, due for a similar reckoning.

Even smaller firms—and their employees—are feeling pressure from abroad on prices and wages. Buck Knives, an American icon based in El Cajon, Calif., began outsourcing 10% of its

production to Asia four years ago. It was not an easy decision. Many buyers of the firm's distinctive dark-handled knives, used for skinning deer and cleaning fish, were unhappy to learn that some Buck knives are forged overseas. But, explains chairman Chuck Buck, "we were getting pressure from dealers to lower our prices. Our filleting knives were selling for \$26. Foreign knives were going for \$14." So Buck outsourced some production, laid off a dozen of his 290 workers and cut the price of some products. He is relocating the company to Post Falls, Idaho, where he expects to spend less on property, energy, taxes—and labor. Buck plans to pay his workers 30% less on average and hopes to bring back some of those overseas jobs.

EXPORTING WHITE-COLLAR WORK

Michael Tucker, 49, fumes when he thinks about computer programmers overseas working for \$20,000 a year—"and to them, that's good money." He was making \$80,000 a year at a programming job in Chapel Hill, N.C., before Temtec USA laid him off last October in a broad cost-cutting move. He has been unable to land a regular paycheck, despite sending resumes to 300 U.S. tech firms. Now, with unemployment benefits running their course, he's trying his hand at commissioned sales for a human-resources company in his hometown. He says he is finished with tech and moans that "computer programmers are the textile workers of the future."

He may be right. It is becoming easier and easier for U.S. companies to outsource not just knife production but also such highly paid tasks as software development and financial research. Financial-services companies in the U.S. say they expect to transfer 500,000 jobs, or 8% of industry employment, to foreign countries over the next five years, according to management consultants A.T. Kearney. Why? A call-center employee earns \$20,000 a year in the U.S. but only \$2,500 in India. And overseas cable costs have fallen as much as 80% since 1999. At the higher end, a researcher with a few years of experience might earn \$250,000 on Wall Street, compared with \$20,000 in India. Those sorts of savings are expected to help the U.S. financial industry cut annual costs \$30 billion a year by 2008, according to A.T. Kearney.

U.S. technology companies are also sending a great deal of work overseas. They now pay foreign firms \$10 billion a year to handle data entry, analysis, customer service and computer

programming—saving themselves many multiples of what they would pay if the work were done in the U.S., says Andrew Dailey, partner of JetStream Group, a San Francisco technology consultancy. More software writing is taking place overseas, particularly in India, Dailey says, where the highly educated, English-speaking work force competes on quality as well as cost. It is a proposition that's attractive to U.S. managers in good times and bad, says Bill Tai, partner at Charles River Ventures. "In the short run, it will put deflationary pressure on wages for people doing the same jobs in the U.S.," he says. "In the long run, many of those jobs will simply disappear."

Underlying the trend is a fundamental shift in how employers view their work force. In the old way of thinking, employees were an investment, like factories or land, says Robert Reich, former U.S. Labor Secretary and now a professor at Brandeis University. Adding workers was a major expense, and cutting them was a decision not taken lightly or often. Today, like copper ore or cotton bales or computer-memory chips, most employees are regarded as commodities to be stockpiled or shed as business warrants. Technology not only allows fewer people to do the jobs of many; it also allows their skills to be taught fairly quickly anywhere in the world. So experience and the investments that companies have made in training count less. Most companies, Reich says, "have started to think of wages as a variable rather than a fixed cost."

NOTHING AUTOMATIC

Annual raises used to be almost a birthright at Avow Technology, an information-systems company based in Little Rock, Ark. "That just won't be the case anymore," says CEO Tom Allen. "When you show me that you are more productive and can deliver a higher level of service, the raises will be there. But they will not be automatic." During the past two years, Allen has levied a 10% pay cut across the board for everyone making more than \$35,000 a year, restored it, then imposed it again. He hopes to avoid such measures in the future by doling out raises more judiciously. "It's a change no one really likes," says Stan Beavers, 38, an Avow account executive. "You just have to continue to better yourself, develop the skills to keep competing."

Pay for performance comes in many flavors, from the largely subjective, merit-based raises that Allen now plans, to more structured rewards for employees who hit specific targets for

production, sales and even self-improvement. The trend is not necessarily bad for workers if it makes their employers more competitive and better able to maintain payrolls—and if it gives workers healthy rewards for efficiency and creativity. "You can end up getting more done in the same amount of time," says George Tamke, partner in Clayton Dubilier & Rice, an investment firm with controlling interests in 13 companies, including Kinko's, of which he is chairman. CD&R is pushing performance-based pay at all its companies. At Kinko's, he says, all employees in all 1,085 locations take part in profit-incentive programs. Cash rewards, as high as 13% of base pay, are paid out monthly. "An average hourly worker might earn an additional \$180 or more each month," he says. "It makes everyone watch the nickels because there is such a direct link between profitability and compensation." And, he says, it gives everyone an equal chance to get ahead. Last year Kinko's paid out \$24 million in performance bonuses, and 85% of its work force got some part of that. Says Laura Sejen, a compensation consultant for Watson Wyatt Worldwide: "Companies are being forced to focus on getting the right dollars to the right people. Across-the-board increases are very, very rare today."

More and more unions are accepting flat pay in hopes of preserving their members' jobs. Next month food-service workers in the Minneapolis public schools can, if they choose, reopen the wage portion of their contract. But Cathy Oberg, 51, who supervises cafeteria cooks at 19 schools, says the union that represents her will probably decline because it suspects that management will ask for an across-the-board 5% pay cut. Oberg has been stuck at the same hourly rate for three years. Her living costs are not going up very fast, and she has her husband's paycheck to fall back on. "We're all giving 110%," she says, "yet you feel like you're going backward." Ramon Sharpe, 39, a nonunion truck driver for C.R. England in Salt Lake City, Utah, echoes those sentiments. He has made the same 32.5(cents) a mile since 1999, and the slow economy means that there is less to haul. "We're all scratching our heads," he says. "This time of year, normally, we're rocking and rolling." He drives on weekends when necessary, though it often means leaving his wife and three children alone. Says Sharpe: "There's no price on that."

BYE-BYE, BENEFITS

Even workers who receive small boosts in their base pay often

see those raises wiped out by cuts in health and retirement benefits. The biggest benefit rollbacks are in heavy industries like steel, in which many union contracts in the U.S. give foreign firms a 10%-to-20% edge in production costs, according to ISG's Ross. He says there is more health-care expense than steel expense embedded in the price of a typical car. In most countries, health-care costs are borne by taxpayers, and until the U.S. levels the playing field, perhaps with a "health-care surcharge," Ross maintains, virtually all large old-line companies that have downsized to stay competitive—Boeing, Goodyear, Kodak, Lucent and Xerox, to name a few—will have to cut benefits as they fight to absorb the outsize costs of their retired work forces. Only 62% of large employers provided health benefits for retirees 65 and older in 2001, vs. 80% a decade earlier, according to a survey by consultants Hewitt Associates. Eight of 10 large employers say they will probably increase the amount employees pay for health care this year, according to the Kaiser Family Foundation. On average, workers today contribute \$174 a month for family coverage, up from \$124 in 1993.

This is all understandable from the company viewpoint. Overall health-care costs are rising about 20% a year, according to industry estimates. Something has to give, and increasingly it is a whole package of benefits. Companies have long been shifting from traditional pension plans, in which workers get a guaranteed income in retirement, to 401(k) plans, in which the pension depends on how much employees saved and how well they invested. And companies like Goodyear, Charles Schwab and Textron are reducing the amount they kick in to workers' 401(k) plans—or suspending company matches altogether. Other firms, such as Target Corp., are dropping paid vacations and health care for some workers.

A pair of bills now moving through Congress would leave workers even further behind in the name of helping companies manage their finances better. The Family Time Flexibility Act would leave it up to employers whether to pay for overtime in wages (as many union workers can now demand) or in compensatory time. The effect of this change would be to reduce income, since most companies would opt for comp time. Democrats oppose the bill, which nonetheless sailed through a House committee. The other bill would let unionized companies reduce their pension obligations by billions of dollars, further imperiling a benefit that is already eroded and underfunded. New

data show that blue-collar workers have shorter life spans than white-collar workers. So, both management and organized labor argue, less pension funding is required—and that would free cash for new jobs and pay raises. But actuaries say the analysis is faulty; it fails to account for the longer lives of many white-collar workers also covered by a company's pension plan.

In the face of these trends, there is plenty that individual workers can do—and are doing—to improve their chances of getting a raise. America has a larger college-educated population than any other country. And in hard times, the national penchant for self-improvement only grows as people prepare themselves for occupations that promise the greatest chance for advancement. And on the job, more Americans have realized that just showing up and doing what they are told won't cut it anymore. Many are thinking more creatively about how their work can make the company more profitable—and they are not shy about letting the boss know what they are accomplishing.

Is there anything American society can do about eroding wages? A major investment in public education is the best solution, says former Labor Secretary Reich. The U.S. work force must stay a step ahead of the rest of the world "to make it possible for more Americans to be innovative and add productive value," he says. That's what keeps jobs at home—and wages going up. But it is a moving target. The world's work force, especially in India and other parts of Asia, is catching up in education. And as long as people there will work for less, wages here will remain under pressure even as the economy recovers.

—*With reporting by Jyoti Thottam, Dody Tsiantar, Amanda Bower and Simon Crittle/New York, Siobhan Morrissey/ Miami, Sarah Sturmon Dale/Minneapolis, Margot Roosevelt/Los Angeles, Paul Cuadros/Chapel Hill, Cathy Booth Thomas/Dallas, Eric Roston/ Washington and Steve Barnes/Little Rock*

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