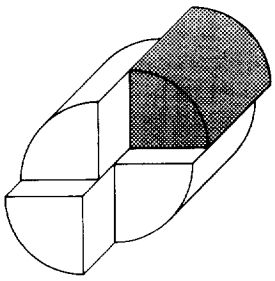

The Quality of Jobs

Flexible benefits plans: employees who have a choice

Although flexible compensation arrangements have generated considerable attention in recent years, such plans were available to only 13 percent of surveyed workers in 1988

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Twice as many full-time employees of medium and large private firms were eligible for flexible benefits plans or reimbursement accounts in 1988 as in 1986. Despite this growth, such plans were available to only 13 percent of workers covered by the Bureau of Labor Statistics' 1988 survey of employee benefits in medium and large firms.[1] Flexible benefits plans, reimbursement accounts, and other arrangements, such as leave banks and alternative work schedules, have been the subject of considerable debate and interest in the 1980's, as employers seek to control benefit costs and employees seek to satisfy individual needs.

Flexible benefits plans, also called cafeteria plans, are arrangements in which employees tailor their benefits package to their specific needs. Employees can select the benefits they value most and may forgo benefits of lesser importance to them. Under a flexible arrangement, an employer allocates a specified amount of money to each employee to "purchase" benefits. In this way, employers control the amount they spend on each employee for benefits, while the employee selects the benefits. This method differs from a traditional benefits program, in which an employer offers a standard package with few, if any, choices to employees.[2]

Reimbursement accounts may supplement flexible benefits plans, or they may stand alone. Reimbursement accounts, also called flexible spending accounts, provide a way for employees to pay for certain expenses that are not covered by existing benefit plans, such as medical care deductibles or dependent care costs. Under these accounts, eligible employees may deposit part of their pay into an account established by the employer, usually before taxes are calculated. In addition, some employers also contribute to the accounts. Employees are then reimbursed from these accounts for specified expenses.[3]

The choices that employees make through their flexible benefits plans, reimbursement accounts, and other forms of flexible compensation reflect the worth employees place on benefits. This article explores changes in the work force that have led employers to offer flexible compensation arrangements, the choices employees have made, and some means being used to measure the payout of benefits. (A more theoretical approach to deriving a value of employee benefits in relation to their costs to the employer is discussed by Melissa Famulari and Marilyn Manser on pages 24–32.)

Changing demographics

Over the last two decades, the labor force has grown by more than 50 percent, and its composition has changed dramatically. One key development has been the increasing participation of women. In 1988, women accounted for 45 percent of the labor force, compared with 37 percent in 1968. Fifty-seven percent of women age 16 and older participated in the labor force in 1988, up from 42 percent in 1968. And not only are women participating increasingly in the overall labor force, but they now make up a larger share of employment in some industries and occupations traditionally dominated by men.

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Another major change in the labor force is the increasing proportion of dual-income families. In 1968, the husband and wife were earners in 45 percent of married-couple families. By 1987 (the most recent year for which data are available), this proportion had risen to 57 percent. Conversely, the husband was the sole earner in 35 percent of married-couple families in 1968, compared with 19 percent in 1987.

Changes in the composition of the labor force have led to changing benefits needs of its members. More dual-earner families can lead to duplication of certain benefits, such as health insurance, which is commonly available to employees and families. Conversely, dual-earner families have needs that may not be satisfied by traditional benefits packages—for example, they may require child care and time off to tend to family commitments. Hence, a uniform benefits package that usually consists of health care, life insurance, income protection during short-term disabilities, a pension plan, and a paid vacation may no longer be suited to a changing labor force.

The industrial composition of today's labor force is also quite different from that of two decades ago. In 1988, 18 percent of all workers were in manufacturing, down from 29 percent in 1968. Offsetting this decline is the increase in employment in service-producing industries—including wholesale and retail trade, finance, transportation, and other services—to 76 percent in 1988, compared with 65 percent in 1968.[4]

Employers, faced with domestic and foreign competition, are looking for ways to control costs, including employee benefits costs. No longer can employee benefits be considered "fringes of compensation"; in 1988, benefits accounted for slightly more than 27 percent of the cost of total compensation.[5]

Another factor that may influence the growth of flexible compensation is the increase in mergers and acquisitions among U.S. firms. Flexible benefits plans may be used to integrate benefits offered to a newly merged work force. In this way, employees can keep their existing benefits even though they now work for a different company. Each factor—the changing composition of the labor force, employers' encounters with foreign and domestic competition, and mergers and acquisitions among firms—has resulted in increased interest in flexible compensation arrangements, such as flexible benefits plans, flexible work schedules, and leave banks.

Incidence of flexible plans

Although growing in incidence and receiving considerable interest, flexible benefits plans and reimbursement accounts are not widespread. According to the 1988 survey of employee benefits, 5 percent of full-time employees were eligible for flexible benefits plans, and 12 percent were eligible for reimbursement accounts. These plans are more common among white-collar workers than among blue-collar workers.[6] Seven percent of professional and administrative workers were eligible for flexible benefits plans in 1988; only 2 percent of production and service workers were eligible. Reimbursement accounts were available to 20 percent of professional and administrative workers, compared with 5 percent of production and service workers. (See table 1.)

In the BLS 1987 survey of employee benefits in State and local governments, 5 percent of full-time employees were eligible for flexible benefits plans and 5 percent were eligible for reimbursement accounts.[7] Teachers (at 8 percent) were twice as likely as regular employees (4 percent) and four times as likely as police officers and firefighters (2 percent) to be eligible for a flexible benefits plan.[8] (See table 1.) However, the disparity was much smaller for reimbursement accounts for which 5 percent of teachers, 4 percent of regular employees, and 3 percent of police and firefighters were eligible.

Flexible benefits plans were first instituted in 1974 at an East Coast service firm and a West Coast manufacturing firm. For several years there was little additional interest in such plans, as employers waited to gauge employee reaction, and for legal uncertainties to be resolved. With the addition of Section 125 of the Internal Revenue Code, effective in 1979, the legal uncertainties began to disappear. During the 1980's, the incidence of flexible benefits plans has slowly increased.[9]

Plan design

In a flexible benefits plan, the employer allocates a specified amount of money to each em-

Table 1. **Full-time employees eligible for flexible benefits plans and reimbursement accounts, medium and large firms in private industry, 1986 and 1988, and State and local governments, 1987**

Coverage	Private industry, 1986				Private industry, 1988 (pre-expanded scope)[1]			
	All employees	Professional and administrative employees	Technical and clerical employees	Production employees	All employees	Professional and administrative employees	Technical and clerical employees	Production and service employees
Total	100	100	100	100	100	100	100	100
Eligible for flexible benefits and/or reimbursement accounts[2]	5	9	8	2	15	23	20	6
Flexible benefits	2	4	2	1	6	9	10	2
With reimbursement accounts	2	3	2	(3)	5	8	8	1
Reimbursement accounts	5	9	7	1	14	22	19	5
Freestanding reimbursement accounts	3	5	5	1	9	14	11	4
Not eligible for flexible benefits or reimbursement accounts	95	91	92	98	85	77	80	94

Coverage	Private industry, 1988 (expanded scope)[4]				State and local governments, 1987			
	All employees	Professional and administrative employees	Technical and clerical employees	Production and service employees	All employees	Regular employees[5]	Teachers	Police and firefighters
Total	100	100	100	100	100	100	100	100
Eligible for flexible benefits and/or reimbursement accounts[2]	13	20	18	6	9	8	11	4
Flexible benefits	5	7	8	2	5	4	8	2
With reimbursement accounts	4	7	7	1	1	1	2	(3)
Reimbursement accounts	12	20	17	5	5	4	5	3
Freestanding reimbursement accounts	8	13	10	4	3	3	3	3
Not eligible for flexible benefits or reimbursement accounts	87	80	82	94	91	92	89	96

[1] These data include only establishments covered by the pre-expanded survey and are directly comparable with the 1986 survey.

[2] Flexible benefits plans (or cafeteria plans) allow employees to choose from a selection of benefits those that they value most highly. Reimbursement accounts (or flexible spending accounts) provide money for expenses not covered by existing benefits plans.

[3] Less than 0.5 percent.

[4] These data are not strictly comparable with 1986 data. The 1988 survey covered firms in private sector industries, except agriculture and households (maids, housekeepers), employing at least 100 workers. The 1986 survey excluded several major service industries, and minimum employment ranged from 50 to 250, depending on the industry.

[5] Workers other than teachers, police, and firefighters.

NOTE: Sums of individual items may not equal totals because some employees were eligible for both flexible benefits plans and reimbursement accounts.

ployee to purchase benefits. Many plans also will permit employee contributions if the cost of the desired benefit exceeds the employer allocation. Such contributions are often deducted before taxes, reducing the employee's taxable income.

In most flexible benefits plans, employees may choose from a variety of health care and life insurance options. Some plans permit the purchase of various levels of sickness and accident insurance, long-term disability insurance, and additional vacation and sick leave days. Employees may also "sell" vacation and sick leave days to buy other benefits. A few plans offer dependent care, adoption assistance, and legal assistance benefits. Many plans permit employees to take cash in lieu of benefits, and some allow contributions to a deferred compensation account, such as a 401(k) savings and thrift plan.

Data from individual employers on the extent of workers opting for cash over some or all of their flexible benefits package show no clear trends. In some cases, only about 10 percent of workers chose cash in lieu of benefits, while in one establishment nearly 65 percent of workers chose cash.[10] In many cases where a cash option is available, employees are not allowed to trade all benefits for cash. Instead, a minimum level of benefits must be chosen, while additional benefits may be declined in favor of cash.

Reimbursement accounts are commonly developed as independent accounts, but may also be established as part of a flexible benefits plan. As noted earlier, these accounts are usually

funded by employee pretax contributions. In a few cases, employers may contribute directly to a freestanding reimbursement account, or if the account is part of a flexible benefits plan, an employee may deposit part of the employer's plan allocation into the account.

Reimbursement accounts are established to help pay for certain expenses specifically mentioned in the plan. Generally, there are two types of accounts: health care and dependent care. A typical health care account reimburses an employee for such items as premium contributions, copayments, deductibles, and other expenses not covered by the employer's health plan.[11] A typical dependent care account reimburses an employee for day-care expenses for dependent children, dependent parents, or disabled dependents such as spouses. In rare cases, reimbursement accounts may be established for legal expenses. The following shows the coverage of certain expenses by reimbursement accounts in medium and large private firms in 1988:

Typically covered

- Health care deductibles, copayments, and coinsurance
- Health expenses not covered by the employee's health plan
- Dependent care expenses

Covered less frequently

- Employee's share of health care premiums
- Other insurance premiums such as life insurance
- Legal expenses

Some case studies

Because of the small number of flexible benefits plans reported in the 1988 survey of employee benefits, the Bureau cannot project the survey findings into economy-wide estimates. However, individual situations from the benefits literature and from the survey illustrate choices made by employees. Indeed, flexible benefits have had varying effects on employee behavior. The following compares experiences of a large bank with those of a service organization.

A bank's experience. Prior to implementation of the bank's flexible benefits program, an employee opinion survey revealed that only 39 percent of its employees were pleased with their benefits package, even though the medical and dental plans were entirely paid by the employer. The company introduced a flexible benefits program that included various levels of health, life, accidental death and dismemberment, and long-term disability insurance coverage. In addition, the program included reimbursement accounts covering health and dependent care, a 401(k) savings plan, and the ability to buy or sell vacation days.

Nearly all of the employees (94 percent) changed some benefits in the first election; 30 percent changed health coverage; 52 percent, life coverage; 39 percent, long-term disability coverage; and 43 percent, vacation benefits. In addition, 53 percent of the employees participated in the health care reimbursement account. The bank's flexible benefits program appears to be a success; when the employee opinion survey was repeated 2 years later, 87 percent of the employees were pleased with their benefits package.[12]

Service organization's experience. Although the bank's employees took considerable advantage of their flexible benefits program, the story at the service organization was quite different. Before the flexible benefits program began, a company survey found that 57 percent of the employees wanted to select their own benefits; 61 percent of them said they would take less of one benefit to get more of another. But, 88 percent of employees selected a benefits package very similar to their coverage prior to implementation of the program.[13]

Other experiences. Another establishment offered a flexible benefits program in which employees received an amount of money based on their pay, years of service, job grade, and age. With this money, employees could purchase health coverage, life insurance for themselves and their dependents, accidental death and dismemberment insurance, survivor income benefits, and long-term disability insurance. They could also buy or sell up to 5 vacation days, receive cash in lieu of benefits, and deposit money into health and dependent care reimbursement accounts.

Employees could choose from four levels of medical plans (basic, medium, high, and premium), three health maintenance organizations (HMO's), and a dental plan.[14] They were allowed to waive health benefits, but only if they were covered as a dependent under another group medical plan (6 percent waived their health benefits). HMO's and high benefits plans were the most popular, each selected by 29 percent of employees, followed by basic plans with 21 percent of employees; premium plans, 10 percent; and medium plans, 5 percent. Most employees (94 percent) also selected dental benefits.

Employees could choose life insurance coverage equal to one of five multiples of annual pay.

Thirty-one percent of employees chose one-half annual pay; 21 percent chose one times pay; 19 percent, two times pay; 17 percent, four times pay; and 12 percent, three times pay. Of the three long-term disability benefits plans, 57 percent of the employees chose the plan replacing half of annual pay, 31 percent chose to replace seven-tenths of pay, and 12 percent chose to replace six-tenths of pay.

Experiences with public plans. Flexible benefits plans in State and local governments are frequently not as comprehensive as those in the private sector. According to the Bureau's 1987 survey of employee benefits in State and local governments, public sector plans generally restrict options to health care coverage and life insurance. Often, employees are permitted to receive cash in lieu of benefits, and a few plans offer various amounts of long-term disability coverage. Flexible benefits plans in State and local governments generally do not include reimbursement accounts; only 1 in 5 employees eligible for a flexible benefits plan in 1987 was also eligible for a reimbursement account. Public sector flexible benefits plans almost never include 401(k) plans, vacation, or sick leave options.

The experiences of a large Southwest city show that even when choices are limited, employees have very definite ideas of what benefits they prefer.[15] With the implementation of flexible benefits in 1986, the city's employees could choose between different levels of medical and dental care, and could improve disability protection. Several benefits were specifically excluded from the plan, such as life insurance and vacations. Prior to implementing the new program, 60 percent of employees chose the fee-for-service plan and 40 percent chose the HMO. In addition, 63 percent chose dental care. These numbers were virtually unchanged under the flexible benefits plan, but nearly all fee-for-service plan participants opted for a different deductible than the one provided under the old plan. In most cases, a lower deductible was chosen. Likewise, one-third of dental plan participants, when given the choice, switched from a fee-for-service plan to a plan in which services are provided free, or for a small, fixed fee. Few of the city's employees chose the additional disability coverage that was offered.

Other flexible arrangements

The needs of the changing work force have prompted interest in other forms of flexible arrangements. For example, to accommodate the special needs of two-earner and single-parent families, some employers have adopted flexible work schedules. These programs range from allowing employees to vary arrival and departure times to permitting employees to work extra hours on some days and fewer hours on other days. A recent Bureau of Labor Statistics survey of private and public sector establishments with 10 or more employees showed that 43 percent of the establishments offered flexible work schedules.[16]

Leave banks are also receiving attention. These programs combine several forms of paid leave—for example, vacation time, sick leave, and personal leave—into one leave category. Restrictions on the purposes for which leave may be used are relaxed, giving employees more flexibility in meeting their needs.

Another practice, found primarily in public school districts, is leave-sharing programs. These plans typically allow employees to donate sick leave each year into an "account," which can be drawn upon by employees who have exhausted their own sick leave due to lengthy illnesses. The Federal Government is experimenting with this type of leave-sharing policy. Early indications are that fellow employees are generous in donating their leave, and that those with lengthy illnesses are benefiting. The literature indicates that other employers are beginning to adopt a variety of flexible leave policies.[17]

Greater employee choice has also been evident in insurance and retirement benefit programs. Data from the Employee Benefits Survey show that the proportion of establishments offering full-time employees more than one medical plan has risen from 13 percent in 1980 to 32 percent in 1984, then to 54 percent in 1988.[18]

Dual-earner families have needs that may not be satisfied by traditional benefits packages.

To help curb rising health care costs, employers may offer workers alternatives to traditional fee-for-service health insurance plans. Among medium and large firms, participation in HMO's (which are often offered in addition to fee-for-service plans) rose from 3 percent of health care plan participants in 1980, to 5 percent in 1984, and to 19 percent in 1988.[19] A more recent plan, preferred provider organizations, grew from 1 percent of participants in 1986 (the first year studied) to 7 percent in 1988.[20] (Preferred providers are groups of hospitals, physicians, and dentists who contract to provide health care services. These plans limit reimbursement rates when participants use the services of nonmember providers.)

Employers have also built flexibility into their retirement programs by introducing salary reduction or 401(k) plans. Relatively unknown in 1980, these plans were available to one-third

of full-time employees in medium and large firms in 1988.[21] Employees can reduce their taxable income by channeling part of their earnings into long-term retirement and savings plans. Typically, employees choose whether to join the plan and the amount to save, subject to a maximum limit. These plans allow employees to use their own contributions to supplement employer-sponsored retirement plans (such as defined benefit pension and profit-sharing-plans) and, in effect, create their own retirement program.

Measuring payouts

Comparing employee benefits plans is difficult because plans typically consist of many provisions. For example, how does a health insurance plan with a $100 deductible, an 80-percent coinsurance rate, extensive mental health care coverage, and an employee premium of $100 per month compare to an HMO plan with no deductible, a coinsurance rate of 100 percent, restrictive mental health care coverage, and an employee premium of $20 per month?

To meet the needs of data users who have requested simpler measures, the Bureau is working on several statistical models that estimate plan payouts.[22] The models compute payouts by making certain assumptions about plan provisions. As with any model, these are simplified versions of reality: They do not take into account the circumstances of individual workers or employers, and they do not consider all factors affecting payouts.

The first of these models used 1984 defined benefit pension plan data.[23] For each pension plan, monthly benefits and replacement rates (the percentage of preretirement income replaced by pension benefits) are computed for employees with assumed final earnings and years of service. These data are averaged to estimate benefits for all defined benefit pension plan participants. Calculations take into account benefit formulas, service maximums, Social Security integration, alternative methods of computing benefits, and other features.[24] Future plans include expanding the replacement rate calculations to account for reduced benefits at early retirement and for survivor benefits.

In 1986, the replacement rates model calculated that participants in defined benefit pension plans in medium and large private firms with 30 years of service and final year earnings of $25,000 would have an average of 28 percent of preretirement earnings replaced by their plan benefits. If primary Social Security benefits were included, the replacement rate rose to 62 percent. Data from the 1987 survey of State and local governments showed higher replacement rates, and variations in benefits, depending on Social Security coverage.[25]

What's ahead

The Bureau is preparing other models. Perhaps the most ambitious is a measure to summarize payouts from health care plans. This model will compute the benefits paid by the health plan and the expenses the employee must pay in a number of annual medical scenarios. For each health care plan in the survey, the total cost of a medical procedure will be compared with deductibles, copayments, maximum dollar limitations, coinsurance rates, and out-of-pocket expense limits to determine the plan's and the employee's share of costs. Employee premiums will be included in calculations to determine total employee costs for a year. To highlight distinctions among plans, data will be tabulated separately for HMO's and, perhaps, for other variables.

Also planned are the results of an analysis of life insurance benefits available to employees. For each life insurance plan in the Employee Benefits Survey, coverage was computed for employees, based on assumed earnings and years of service. These data were averaged for the entire survey, revealing typical benefits available to a beneficiary upon death of an employee. Additional calculations provide the average insurance coverage for older active employees, whose benefits may be reduced as the cost of coverage increases.

In addition to the Bureau's work on the payouts of pension, health care, and life insurance plans, the Employee Benefits Survey will expand its coverage of flexible compensation. The 1989 survey collected information on the incidence of flexible work schedules, and in 1990, data will be collected on the incidence of leave banks. Also in 1990, the survey will improve its coverage of flexible benefits plans and reimbursement accounts to acquire more specific details on these plans. At the same time, the survey coverage is expanding. Medium and large private firms will be surveyed in odd years, and small firms (from 1 to 99 employees) and governments in even years. These changes should enable the Bureau to chart developments in flexible compensation more extensively throughout the economy. □