Compensation trends into the 21st century

Changing family characteristics and labor force trends suggest more flexible and more varied pay and benefit packages as the U.S. enters a new century

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To help mark the Monthly Labor Review*'s 75th year, the editors asked both data users and data producers to speculate about programs and data needs in 2015, when the* Review *will mark its centennial. This article and the article beginning on page 46, deal with the Bureau's compensation programs.*

Are recent changes in the ways employers compensate their employees prologue to a new compensation system in the 21st century? In the 1980's, we have seen the waxing and waning of two-tier wage and benefit systems, the surge of lump-sum payments made to employees in place of wage-rate increases, and the appearance of flexible employee benefit plans. Whether such changes will endure is still being debated.

The debate is well framed within the broader context of U.S. industrial relations in two May 1988 *Monthly Labor Review* articles. John Dunlop argues that "no fundamental change" occurred in the 1980's, while Audrey Freedman insists, "This change is for good."[1] No doubt, employer-employee relations will be a central force in determining the size and makeup of future employee compensation packages, but the shape of these packages also will be influenced by the changing needs of employees and their families.

This article reviews compensation trends and speculates on how compensation packages in the next century might respond to the changing characteristics of the U.S. work force and to the needs of workers and their employers. Will pay for time worked continue to make up the lion's share of total compensation costs? Will the relative importance of individual employee benefits (such as paid leave, insurance, pensions, legally required benefits) remain constant or change? Will flexible or discretionary forms of employee compensation become more prevalent?

The emergence of benefits

The way American workers are compensated for their labor underwent dramatic changes in the middle third of this century.[2] In the early 1930's, compensation of the Nation's workers was made up almost entirely of wages for time worked or pay for units of output. Benefits as we know them today were virtually nonexistent except for workers' compensation programs in several States. Workers had to seek ways to protect themselves and their families from the hazards of life and work—sickness, accident, unemployment, and old age.[3]

The turmoil of the Great Depression highlighted the vulnerability of workers and their families in coping with economic uncertainty. These conditions led to passage of the Social

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Security Act in 1935, providing workers with protection against loss of income from old age and temporary unemployment.[4] The protection—funded by payroll taxes—became a widespread, legally required benefit beyond direct pay.

The Second World War brought inflationary pressures, stemming from intense competition among employers for scarce labor resources, and pent-up demand for very limited supplies of domestic goods. To deal with these pressures, the War Labor Board controlled increases in cash wages, while employers were encouraged to offer forms of compensation that were considered "noninflationary." Thus, compensation practices began to shift from direct pay to "fringe" benefits such as paid holidays and vacations, insurance, and pensions.

Employee benefits became even more widespread in the postwar years. Such compensation items were incorporated in package settlements hammered out by labor and management. The growth of employee benefits also was spurred by 1948–49 court interpretations of the Wagner Act of 1935, which expanded the act's scope to benefits in addition to its traditional coverage of wages, hours, and working conditions.[5]

Post-World War II trends

The spread of employee benefits during the post-World War II years also was aided by tax incentives and group purchase discounts. Employer-paid health insurance, for example, had a threefold appeal to workers: (1) protection from the relatively high costs of medical and hospital expenses for themselves and their families, (2) lower rates for group insurance purchases than those available to individuals, and (3) tax advantages for those who received insurance benefits from their employers, rather than cash subject to income taxes.

Compensation packages emerging from the 1930–60 period were made up of pay for time worked and a group of employee benefits that had almost universal appeal to American workers of that time. The benefits were particularly attractive to the typical worker—a husband supporting a nonworking wife and children. The benefit group featured: supplemental pay, including nonproduction bonuses; paid holidays and vacations; life, health, and sickness and accident insurance; retirement and savings plans; and legally required benefits such as Social Security, Federal and State unemployment insurance, and workers' compensation.

The shape of employee compensation packages continued to evolve throughout the 1960's, the 1970's, and into 1980, with wages and salaries rising at a slower pace than employer costs for employee benefits. As a result, benefit costs made up a larger share of compensation costs. (See chart 1.) The growth of benefits during the 1960–80 period typically occurred through improvements to existing plans rather than the introduction of new ones.

A major influence on benefits during this period came from the government. In 1974, the Employee Retirement Income Security Act (ERISA) became law, setting standards for benefit plans. One effect of ERISA was to bring stability to existing benefits, through required funding standards and mandatory provisions. Later Federal legislation, as well as action on the State level, continued this trend of securing benefits under employer-provided plans, rather than mandating benefit coverage.

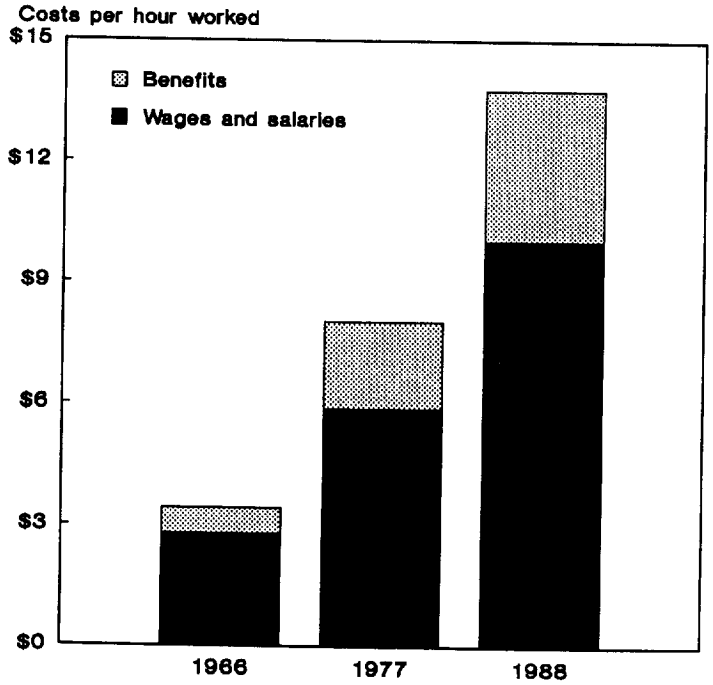
The role of unions. The structure of employee compensation in the 20th century also was influenced by other institutions, including organized labor. The development of legally required insurance programs in the 1930's and the emergence and growth of private insurance programs and paid leave in the 1940's and 1950's coincided with the growth of the labor movement, which worked to improve the lot of its members.

Union membership as a proportion of nonagricultural employment was 11.3 percent in 1933, rose to a peak of 35.5 percent in 1945, and remained around 33 percent through the 1950's. Beginning in 1960, however, union membership declined as a proportion of nonagricultural employment. By 1988, labor organization membership had fallen to 16.8 percent of employment.[6]

Union membership losses during the 1980's partly resulted from economic conditions which not only affected organized labor, but had a particularly strong influence in shaping employee compensation packages. The U.S. economy slipped into a mild downturn in 1980, briefly recovered, then plunged into the longest and deepest recession in the post-World War II era. Employment declined by nearly 3 million, with job losses heavily concentrated in manufacturing. With the unemployment rate reaching nearly 11 percent, coupled with a steep drop in the rate of price increases, the industrial relations focus (and collective bargaining strategy) shifted from pay increases and improved benefits to job security. This shift occurred against a backdrop of concerns about the growing national debt, the international imbalance of payments, foreign competition in domestic markets, outdated plant and equipment, and deregulation of several industries such as transportation and communications.

The way American workers are compensated for their labor underwent dramatic changes in the middle third of this century.

Chart 1. **Components of employer costs for employee compensation, private industry, 1966, 1977, and 1988**



Developments in the eighties. The 1981–82 economic climate was reflected in the 1983 round of collective bargaining settlements. There were pay cuts and freezes, lump-sum payments to workers instead of wage-rate increases, and benefit reductions. Two-tier wage and benefit systems (typically providing higher wages and richer benefits for current employees than for the newly hired) began to emerge. It was these developments that sparked debate over whether fundamental changes were occurring in the way U.S. workers are compensated.

Bargaining settlements over the 1983–88 period showed mixed patterns in their treatment of nonwage items. Lump-sum payments, including those based on profit sharing, were introduced or became a more important part of the compensation package. Health plan cost containment measures (for example, higher deductibles, second surgical opinions) became more widespread. Employer-employee joint funding of health insurance became more pronounced, as plans financed entirely by employers began to wane. Two-tier wage and benefit systems began to fade as well, after a brief surge of popularity.

Reaction to the economic conditions of the 1980's had an impact on employee compensation packages, but more subtle (perhaps more durable) influences were beginning to emerge. These emerging trends, found in the nonunion setting as well as in collective bargaining settlements, appear to be related to individual needs of workers and their families. A change in family structure has made the traditional benefit package less appealing, and has led to the growth of flexible benefit plans and reimbursement accounts, child care benefits, and parental leave.

The incidence of flexible benefit plans and reimbursement accounts rose from 5 percent of full-time workers in 1986 to 13 percent in 1988, according to a BLS Employee Benefits Survey in medium and large firms.[7] Flexible benefit plans (often called cafeteria plans) allow workers to choose from a menu of benefits offered, which they can tailor to their own needs. The most common benefits offered under flexible plans were life, health, and long-term disability insurance, along with the option to receive cash instead of benefits.

Reimbursement accounts provide funds from which workers pay for expenses not covered by their regular benefit package. The accounts are financed either wholly or partly by the employer, or entirely by the worker. The accounts typically cover such expenses as the worker's share of insurance premiums, dependent care, or health care deductibles and coinsurance expenses. Funds for the accounts usually come from workers seeking tax advantages through salary reduction arrangements; employer contributions are less frequently found. (It should be noted that reimbursement accounts are separate from savings and thrift plans, under which employer and employee contributions are not taxed until they are withdrawn from the plan. Savings and thrift plans covered about a fourth of the employees in medium and large firms in 1988.)

Family concerns. The 1988 Employee Benefits Survey indicated a slight increase in workers eligible for employer-subsidized child care benefits—4 percent, up from 1 percent in 1985. Such benefits included reimbursement for child care expenses, as well as facilities provided by the employer.

Another emerging benefit provides leave to new mothers or fathers to care for their children during the early days of infancy. The leave is separate from that granted under other leave plans, such as short-term disability coverage and paid vacations, which also might be used as parental leave. In 1988, *unpaid* maternity leave was available to 33 percent of the employees in medium and large firms, while *unpaid* paternity

leave covered 16 percent. Both maternity and paternity leave benefits averaged 4 months in duration. *Paid* parental leave provisions rarely were found in the firms surveyed.

Reimbursement accounts, child care benefits, and parental leave also are beginning to emerge in collective bargaining settlements. For example, the widely reported settlement between the American Telephone and Telegraph Co. (AT&T) and the Communication Workers of America (CWA) and International Brotherhood of Electrical Workers (IBEW) focused on "family care benefits."[8] AT&T said the need for such benefits was obvious from a 1987 survey of its employees (53 percent of whom are women), which reflected growing concern about caring for their families, particularly children.[9]

The Federal legislative docket also directs attention to the changing needs of the U.S. workers and their families. Some child care proposals would provide direct cash assistance to families for day care, while others include tighter restrictions on health and safety standards for child care providers. Leave proposals may require employers to provide unpaid time off to be used after the birth or adoption of a child and during illness of the employee or his or her child or parent.

Another consideration that might help shape compensation packages offered by U.S. employers is the diversity of these packages across national boundaries. Pay for time worked, for example, accounts for as little as 50 percent of total compensation costs in some countries and as much as 80 percent in others. Other types of pay, primarily vacation and seasonal bonuses, comprise more than one-fourth of Japanese compensation costs, with workers often receiving the equivalent of about 3 months of regular wages in summer and New Year's bonuses.[10] The incidence of social insurance expenditures by employers depends both on the extent of such coverage in each country and on whether the coverage is financed directly by the government or through payroll taxes. These differences can affect the competitive position of businesses in international markets.

Labor force and employment trends

Employee compensation packages, particularly the benefit components, also have been influenced by the dramatic changes that have occurred in the work force and society over the last three or four decades. In 1950, men constituted nearly 70 percent of the civilian labor force and employers could reasonably assume that most of these workers were the sole support of their families, that these families were not likely to experience divorce, and that workers would stay on the job at least until they reached age 65. Subsequently, dramatic changes in society and in labor force behavior have challenged such assumptions.

Today, men account for only 55 percent of the work force, and more than half of all families have two or more wage and salary earners. The rate of divorce has doubled since 1950, and nearly half of all men leave the labor force before reaching their 65th birthday. Thus, three intertwining threads have been woven in the fabric of labor force changes in the second half of the 20th century: the increasing participation of women, particularly women with children; the growth of multi-earner families; and the ability of more men to retire at earlier ages.

Women workers. Probably the most dramatic and far-reaching change is the extraordinary rise in labor force activity among women with very young children. The historical pattern in the United States had been for many women to work for a few years upon completing school, leave the labor force upon marriage or childbirth, and sometimes return after their children were grown.

What is different today is not only that a much greater proportion of young women enter the work force, but that most of them leave very briefly, or not at all, following the birth of their children. For example, it took two decades, from 1950 to 1970, for the labor force participation rate of married women with preschool children to increase from 12 to 30 percent, but by 1984, more than half of such mothers were working; by 1988, the proportion was at 57 percent. Among wives with school-age children, the proportion engaged in labor market work exceeded 72 percent. Even more striking is the fact that mothers of toddlers were more likely to work than not.[11]

With the increased labor force activity of women has come an increase in the number of families with more than one wage earner. In fully 57 percent of all married-couple families, both the husband and the wife are earners. Naturally, the more earners in the family, the higher the family income. In 1988, in traditional married-couple families, where the husband worked but the wife was not a labor force participant, median weekly family earnings were $489; in families where both the husband and wife worked, earnings averaged $824. On average, working wives contribute about 30 percent of family income. This ranges from 13 percent for wives who work only at part-time or part-year jobs to 40 percent for those who work year round, full time.

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There also has been a marked increase in the number of families maintained by women on their own. About 10 percent of the 1988 labor force consisted of people living in such families; another 3 percent consisted of people living in families maintained by men on their own. Another one-fifth of the work force lived alone or with nonrelatives. Nonetheless, two-thirds of all workers still live in married-couple families in which a little more than half the working members are wives and children.

A change in family structure has made the traditional benefit package less appealing.

Early retirement. At the same time that the labor force participation of women has been increasing, participation of men declined. This was primarily due to earlier retirement, as the increased availability of retirement income from private and public pensions and from disability benefits gave more men the option to retire. The rapid decline began to taper off starting in 1985. Still, only a little more than half of all men between 60 and 64 are currently working; in 1950, more than 80 percent of men in this age group were still in the labor force.

Age 62, the first year of eligibility for Social Security benefits, seems to be a watershed for labor force behavior. Up until that age, older men work in similar jobs and for about the same number of hours as younger men. But, once eligible for Social Security income, many men leave the labor force and many of those who continue to work move from full-time, year-round jobs to less demanding schedules. This movement often requires a job switch because part-time opportunities are much more common in retail sales and some service industries than in other sectors of the economy.[12]

Structural changes. Structural changes in the economy and changes in employer-employee relationships also have had substantial impact on the compensation package. The rapid growth in the service-producing sector coupled with slower growth, and even some declines, in the goods-producing sector have affected the industry and occupational mix. Since 1950, the proportion of our work force engaged in agriculture has declined from 14 percent to 3 percent. The rest of the goods-producing sector—manufacturing, construction, and mining—used to provide jobs for more than one-third of our workers; now it provides less than one-fourth of all jobs. The number of government jobs has grown slightly (primarily at the State and local level), while private service-producing jobs have increased sharply, and currently account for nearly 60 percent of all jobs.

The needs of employers in these fast-growing industries, coupled with the needs of many of today's labor force entrants, have led to an increase in the number of what are often called contingent workers. While there is not as yet consensus on either a definition or a complete count of these workers, there is general agreement that the term should refer to workers whose tie to their employer is relatively loose. Workers employed by temporary help supply firms, who are recruited and paid by one firm but actually provide their services to another company, are often cited as an example of this new contingent relationship. Other examples include on-call workers, leasing arrangements, and contracting out.[13]

There has also been a dramatic shift in the age composition of the labor force. In the 1960's and 1970's, the labor force grew rapidly as the baby-boom generation reached labor force age. From 1960 to 1979, the number of young people (ages 16–24) in the labor force more than doubled, and the youth share of the labor force rose from less than 17 percent to more than 24 percent. Subsequently, the number of young people has declined. In 1988, young people accounted for 19 percent of the labor force, and their share is projected to decline to 16 percent by the year 2000. With relatively fewer young people in the population, the overall labor force is expected to grow more slowly in the future, and employers may have to be more creative in designing attractive compensation packages as a recruitment strategy.

The next 25 years and beyond

As we project these demographic and economic trends through the next 25 years and beyond, we expect a diverse labor force with varying family concerns, on the one hand, and tight labor markets demanding highly educated and skilled workers, on the other. These converging developments suggest a match-up of a highly trained labor force having diverse needs with flexible compensation packages designed to attract and retain these scarce labor resources.

Traditional approaches to employee pay and benefits (targeted to the "traditional" worker of the mid-20th century) may well become impractical. In their place, employers, either unilaterally or through the collective bargaining process, may try to design compensation packages that can be tailored to individual workers' needs, while continuing to seek ways to control labor costs.

To keep its surveys relevant, the Bureau of Labor Statistics must be mindful of these emerging developments in compensation structures. In times of flux, it is both more important and more difficult to design surveys that will

capture new forms of wages and benefits. The greater flexibility that employers have offered in benefit plans over the past several decades has resulted in more options to the employee, but also more complex administration for the employer and more difficulty in data collection for the Bureau. For example, instead of obtaining information on one health plan that covers all workers in the establishment, BLS now must obtain information for several plans, some of which may contain multiple options. Measurement becomes even more complex when employees get to choose among different categories of benefits. Should BLS measure the number of workers eligible for a benefit or the number receiving the benefit? Or must we measure both, because each provides useful information? Issues such as these affect not only survey design, and questionnaire development, but also collection procedures, data processing, and analysis.

Although we cannot, of course, predict the future with certainty, the persistence of long-term trends suggests the likely shape of the major components of employee compensation packages.

Basic and supplemental pay. Pay for time worked or for units of output currently makes up about 70 percent of employer costs for employee compensation. Basic pay will very likely continue as the major component of employee compensation, but its relative importance may diminish as employers seek more control over labor costs.

Basic pay rates are one of the most rigid forms of employee compensation. Once rates are established and upward adjustment practices are put in place, it takes major economic upheavals or dire circumstances at the firm to break expected patterns. Until the 1981–82 recession, for example, wage-rate freezes and cuts were a rarity in the post-World War II era.

Rigidity in basic pay was, no doubt, a major consideration in employers' decisions in the 1980's to pursue the payment of lump-sums to workers, along with bonuses tied to a firm's profits or other favorable contingencies, instead of wage rate increases. These and other flexible forms of compensation may continue to appeal to employers in the next century.

Supplemental payments also may appeal to certain workers (such as those living in families with other wage earners), particularly if they are designed to provide tax advantages through salary reduction arrangements. For example, reimbursement accounts funded by employers in lieu of wage increases can provide flexibility among employees and also a means of adjustment as individual circumstances change over time. An employee might choose to use the account initially for child care expenses, then shift to elder care expenses when children are grown and parents become invalid.

Supplemental pay also includes traditional items such as shift differential pay, overtime premiums, and nonproduction bonuses, as well as various types of lump-sum payments that arose in the 1980's. Supplemental pay now makes up less than 5 percent of compensation costs; its potential for flexibility may encourage its future growth.[14]

Paid leave. Now accounting for about 7 percent of compensation costs, paid leave offers another opportunity for building flexibility into future employee compensation packages. Traditional approaches to paid leave provide separate plans for holiday, vacation, personal, sick, jury duty, funeral, and military leave. Comprehensive leave plans designed to cover virtually all types of leave were considered by some employers in the past, but have not taken hold despite their potential for flexibility, except in some health services industries. Annual leave plans, akin to comprehensive leave plans, are found in Federal, State, and local governments where they cover vacation, personal, and funeral leave with holidays and sick leave under separate plans.

Employers and employees may revisit the idea of comprehensive leave plans in the next century. Such plans offer leave-accumulation features, allowing individual workers to forgo vacations and holidays to save leave for an upcoming event such as childbirth or parental care.

Insurance. Life, health, and disability insurance accounts for about 6 percent of compensation costs, but this component is growing with the rapid rise in health care costs.

Features adopted in the past decade tended to emphasize health care cost containment by requiring that medical services be certified as necessary before they are performed. Provisions for second surgical opinions covered nearly three-fifths of all health plan participants in 1988, up from one-fourth in 1982. The incidence of provisions requiring prior approval for a hospital stay and incentives to use generic prescription drugs also increased.

If health care costs continue to rise at a faster rate than the general price levels, the quest for cost containment approaches could continue into the next century. One approach may be increased use of "core" benefits for hospitalization and surgery, with employer-financed

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accounts (supplemental pay) from which employees pay for other health care expenses. This approach will afford employers more control over outlays for health care benefits, while giving employees the flexibility to pay for the health care they need.

This so-called defined contribution approach to health care also may be considered for retiree benefits, giving employees the opportunity to set aside pretax funds to purchase health care for their retirement years.

Although we cannot predict future compensation packages with certainty, we are sure to see greater variety and fuzzier lines between pay and benefits.

Retirement and savings. During the past decade, the incidence of traditional defined benefit retirement plans (such as those providing specified annuities based on a formula) declined, while defined contribution plans became more popular. Slightly more than 80 percent of full-time employees in medium and large firms participated in traditional retirement plans in 1980, compared with 70 percent in 1988. When smaller firms and all service industries were added to survey coverage in 1988, the proportion dropped to just over 60 percent. This trend is likely to continue as employers attempt to control liabilities tied to retirement formulas (such as salary and length of service).

Defined contribution plans commit the employer to a specified outlay of funds, which are invested for the benefit of the employee. Such plans, most often taking the form of savings or profit-sharing accounts, are increasing in popularity. In 1988, about half of the employees in medium and large firms participated in at least one type of defined contribution plan (sometimes in conjunction with a defined benefit plan). These plans typically offer features which encourage employees to participate, such as tax breaks and matching employer contributions.

Future designs in retirement plans will have to deal with ongoing work force trends, including perhaps a looser attachment of employees to one employer. Traditional defined benefit pension plans generally inhibit portability, that is, benefits accrued by the employee are not easily transferred from one employer to another. In such cases, a small benefit from the employee's existing plan is guaranteed years into the future (through vesting), or the employee receives an immediate lump sum equal to the present value of future benefits. In either case, benefits typically are smaller than those available to an employee staying with one employer for an entire worklife.

Defined contribution plans have more built-in portability. The existing value of the employees' accounts is known, and can be taken with them when they transfer to another establishment. In many cases, the employees' accounts are transferred to an Individual Retirement Account, giving the employee control of how funds are invested while limiting access to the funds until retirement age.

The future of defined benefit plans may depend on whether portability features can be incorporated in them. Universal portability systems have been discussed by academics and policymakers, with no action taken as yet. Such a system would transfer service credits from one establishment to another, allowing an employee to build credits from all employers and paying an eventual benefit based on a lifetime of work.

Legally required benefits. These benefits currently account for about 9 percent of total compensation costs. The big-ticket items, in order of relative costs, are Social Security, workers' compensation, and State unemployment insurance. This alignment is likely to continue into the 21st century, unless there are major downswings in the economy causing unemployment insurance costs to rise as funds are drawn down. The relative importance of legally required benefits also will depend on the outcome of public debate over how to deal with rising health care costs and with the needs of the elderly for long-term custodial care.

THIS ARTICLE HAS reviewed historical trends in employee compensation and pointed to some future directions suggested by expected labor force and economic developments. Although we cannot predict future compensation packages with certainty, we are sure to see greater variety and fuzzier lines between pay and benefits.

The Bureau's current compensation programs are being modernized to respond to these developments. In 1987, the Bureau initiated a comprehensive review of concepts and definitions used in its programs. In addition to calling on its own staff, the Bureau solicited help from a wide spectrum of data users, representing business, labor, academe, and Federal, State, and local government. Based upon this review, the Bureau has developed linkages between several of its wage surveys, and is testing the feasibility of obtaining information from employers on the demographic characteristics of their workers, the type and amount of lump-sum payments, and the components of the benefit package for a sample of individual workers. New data collection and processing techniques also are being tested.

By the time the *Monthly Labor Review* marks its 100th anniversary in 2015, we expect that refined concepts and new collection and processing techniques will provide data users with improved measures of both pay and benefits. □