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***Employment Cost Index:***

**Compensation Execs: 2Q Wage Hikes Held Steady as Doubts over Economy Grew**

- Employers Choosing Layoffs Over Wage Cuts then Working People Harder on Same Pay
- Companies Saying Not a Penny More for Health Insurance
- Workers Losing Negotiating Power in Darkening Jobs Climate

By Gary Rosenberger

NEW YORK (EconoPlay) July 21 – As pessimism over the economy intensified in the second quarter, employers grew more adamant about controlling wage and benefits costs – leaving workers to face a lonely battle against higher living costs, compensation consultants say.

Management is opting for layoffs over wage cuts and freezes – but also working people harder for the same amount of pay.

Bonuses and other forms of variable pay are also now at risk as corporate profits lose ground.

Salary budgets being planned now for next year show increases only a hair below that of a year ago, but heavy downward revisions are likely if the economy fails to turn around.

Employers also have reached a limit on paying for health benefits and are demanding actual cost reductions as opposed to just a paring down of increases.

Many thousands got a taste of that last week when they woke up to find GM would stop paying its share of supplemental insurance premiums for non-unionized retirees, and instead would add \$300 to their monthly pensions to soften the blow.

With layoffs now rife and jobs harder to find, workers are losing negotiating power. But management is also showing flexibility on things like a four-day workweek, gasoline subsidies, and telecommuting to keep worker morale up in difficult times.

**Battle Lines on Health Premiums**

“What I’m seeing, maybe for the first time, has less to do with what insurance companies want than what my clients need to do,” said Aaron Berg, president of Health Plan Manager Corp. in Mount Arlington, New Jersey.

His clients are now resisting any increase handed to them by insurance companies. “It used to be that my clients would get a 10 or 15 percent increase and the negotiating would begin,” Berg said. “Now my clients can’t live with any amount of increase. They say the price is already too high – and it has to come down in the same way that \$4 gas has to come down.”

There is no more flexibility in operating budgets, and no more fat left to trim to pay for higher insurance premiums with companies now fighting inflation from all fronts. “Insurers are aware of what’s going on – and general increases on renewals are a lot less than in the past,” Berg said. “Increases have been coming in below 10 percent. But my clients think even that is too high.”

It’s no longer enough to merely slow the rate of increase. “With business conditions the way they are, nobody is cruising anymore. Companies have to save money. They no longer look to design changes, cost shifting, or any of the other techniques they’ve relied on in the past. They’re demanding a straight-out decrease,” Berg said.

Right now, it’s insurance brokers taking the clubbing. “Companies are done paying big brokerage fees. Brokerages have to justify their commissions with more services or lose the business altogether,” Berg said.

### **‘More Pessimism’**

“The biggest change I’ve seen in the last three months is more pessimism. People feel it will take longer to turn this cycle around,” said Steve Gross, employee compensation leader for Mercer Human Resources Consulting, at his Philadelphia office.

“You can’t pick up a newspaper, watch TV, or listen to the radio without another negative story about business. Yet a lot of people overlook the fact that almost 95 percent of Americans are still working,” he said.

It’s not like the U.S. economy is moving in only one direction. “Automotive, airlines and construction continue to sink. But manufacturing is up with a lot of companies exporting more, and energy companies are doing great,” he said.

“Education is fine, healthcare is okay,” Gross said, noting that such industries are being moved by positive demographic trends that can’t be discounted. “Education and healthcare is a very large portion of GDP. The largest employer in my city, Philadelphia, is the University of Pennsylvania.”

Gross conducts regular surveys on compensation and his latest finding is that gasoline prices have changed the behavior of employers: Many now allow a four-day workweek, “which cuts commuting by 20 percent,” he said. “It also has a positive affect on greenhouse gases, and it’s one less lunch workers have to buy.” Another innovation: Companies are also issuing gas cards.

His latest May survey on compensation planning showed companies project a 3.7% salary increase for 2009, “a rounding error compared to the 3.8 percent increase last year,” he said. “Only 2 to 4 percent of companies were freezing or planning to freeze wages.”

But Gross doesn’t think the 3.7% salary increase will hold, and suspects his future surveys will reveal steeper markdowns. “Negotiating power has switched. The majority of it has moved from employees to companies,” he said. “There will be exceptions because of skill shortages. Schools are not graduating enough engineers, and employers will pay for experience.”

But workers “will have a tough time getting the wage increases that would allow them to keep up with inflating living costs,” he predicts.

“As job security concerns mount in a weak economy, it appears there will be more pressure on the downside of our projection,” said Jim Stoeckmann, practice leader at WorldAtWork, an association of compensation and human resource professionals.

WorldAtWork’s latest Salary Budget Survey projects an average increase of 3.9% next year, in line with last year’s projection – when the job market was considerably more stable.

But energy costs and the housing finance crisis “have only intensified” since the end of the first quarter – and that 3.9% increase for next year “could change if the economy continues to stay weak, especially if consumers stop spending,” he said

As long as the economy continues to struggle and job security is at issue, management will continue to have the upper hand in salary negotiations. “Organizations are looking at the global cost of labor, which continues to put downward pressure on domestic wages,” Stoeckmann said.

That also applies to financial services firms that have led the economic decline. “Clearly job security is the No. 1 concern for employees in this sector and compensation will take a back seat for the foreseeable future,” he said.

### **Ways Around Wage Cuts**

“What we’re hearing amid all of the dismal economic news is that salary budgets are remaining the same,” said Paul Gavejian, managing director of Total Compensation Solutions in Armonk, New York. “Employers – our clients – are unwilling to penalize their employees further by holding down wages.”

But if management won’t reduce wages, they can certainly work their people harder. “If a senior executive retires or resigns, their function could be reassigned to another senior executive – and the company saves the recruitment and salary costs for a short period of time,” he said.

Gavejian also sees more companies promoting by title without an accompanying raise.

He also sees companies responding to energy prices by “considering or expanding” their telecommuting programs. “This is a material change for employers, especially in small to medium companies that prefer to have all employees on site every day. It’s one way they can demonstrate concern and provide a better quality work life,” he said.

“It isn’t a happy time for a lot of companies,” said David Leach of Strategic Apex Group, an executive compensation consulting group in Santa Monica, California.

Law firms are gearing up for bankruptcies, and those appearances before a bankruptcy judge to deal with a turnaround situation are never good for workers. “Such situations inevitably mean

workers taking wage cuts, but also big bonuses awaiting any management team that successfully carries out the turnaround,” he said.

Even companies not facing a dire turn “sometimes take a position that workers are lucky to have a job at all,” Leach said. “Only the more forward-looking companies take care of their people and are rewarded with employee loyalty.”

He, too, sees businesses doing more with fewer resources – and among the more desperate, like GM, major takeaways from the most vulnerable. “The loss of retiree health benefits must have come as quite a surprise for people on a fixed pension – but if GM goes under, they lose everything anyway,” Leach said.

Among financial services and other publicly traded companies, “people aren’t counting on their bonuses the way things are going. If companies are not making money, there’s going to be a lot more scrutiny by shareholders on executive pay,” Leach said.

“This is worse than 9/11,” Leach continued. “That was a one-shot event and things came back in a few months. Also, the dotcom bust was more isolated than this. We still had other industries doing well,” Leach said.

He sees people changing their behavior as a result of this downturn, which might be a good thing in some cases. “In California, you see fewer cars on the road. People are starting to use mass transit,” he said. “People don’t change unless they’re forced to.”

### **Cost Healthcare Still Rising**

Jim Watt, president of Employee Benefit Solutions in Houston, sees people “consuming more healthcare” on fears that coverage will end if they lose their jobs. “Layoffs are causing some claim activity to pick up,” he said.

“Job growth, and more importantly, job security have an inverse relationship to healthcare utilization. So if the economy continues to stumble and companies continue to struggle, then healthcare costs will continue to increase,” he said.

It’s too early to measure the severity of the problem he describes because of the lag between people taking care of neglected ailments and the claims coming back to him.

Despite the prospects for more insurance claims, changes in insurance premiums from 2007 to 2008 were relatively modest because insurance companies are reluctant to push increases ahead of a presidential election. “Increases typically tend to be moderate before an election and then move higher after the election,” Watt said.

With employers already stretched thin, “they will shift more of the cost to workers,” he said. “The consumer-directed (high-deductible) health plans being offered by the national carriers are gaining wider adoption, and will likely be the tool that employers use as a hedge to manage cost increases, particularly in this economy.”

With the health insurance negotiating period now underway, “it will be interesting to see how much cost shifting to employees is executed in light of the increase in gas and food prices, projected wages increases generally being behind inflation, and the overall negative economic impact hitting employees today,” said Lenny Sanicola, a practice leader for WorldAtWork.

Healthcare costs, although somewhat more stable than in previous years, “are still in the high single digits and low double digits, and continue to be a concern in our current recessionary environment,” he said.

But companies also know that healthcare is a hot button issue – and there will be changes made even they don’t happen overnight, Sanicola said.

“There is certainly a sense that a Democratic White House in combination with a Democratic-controlled Congress will lean to some form of universal access and national-type system. But I don’t expect companies will walk away that quickly from the employment-based model when 80 percent of those that are covered have coverage through their employers.”

*The U.S. Labor Department is scheduled to release the Employment Cost Index for the second quarter on Thursday, July 31 at 8:30 a.m. ET. The above also looked ahead to the current quarter.*

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