

Reality Check: US Compensation Execs See Renewed Caution On Wages
--Energy Costs To Weigh on Blue Collar Workers the Most
--But Upward Wage Pressures Burgeoning in Gulf Coast and Energy Sector
--Prescription Drug Costs Renew Their Sharp Climb

By Gary Rosenberger

NEW YORK (EconoPlay) – Oct. 19 – Amid skepticism over the U.S. economic recovery prompted by soaring energy costs and two catastrophic hurricanes, employers are reducing their once optimistic compensation budgets for the balance of the year and 2006, say compensation consultants.

Workers, who would bear the brunt of higher commuting costs and exorbitant heating bills this winter, are the likely losers in this retrenchment, they say.

There are, of course, exceptions. The Gulf Coast is experiencing upward wage pressures as businesses attempt to lure back evacuated workers. Similarly, energy companies are in bidding wars to attract workers now that their coffers overflow and they back pedal from years of consolidation and layoffs.

Also offsetting those downward wage pressures is a renewed sharp climb in prescription drug costs, which are certain to raise the overall cost of healthcare benefits for businesses and worker who increasingly share such costs.

In these economically confusing times, the biggest victims are employees for airlines and automakers, who are famously under pressure to decrease labor costs – and blue-collar workers competing with cheap Asian labor.

Paul Gavejian, managing director of Total Compensation Solutions in Armonk, New York, sees a firm thumb holding down earlier optimistic forecasts for 2005 wage increases.

“According to our clients in several industry sectors, there is a slowdown in the wage increases that they’re granting for the balance of 2005 and that they’re planning for 2006,” Gavejian said.

The original plan was for broad-based increases for 2005. “But the general economic issues of higher taxes, higher deficits, higher energy costs, hurricane relief, have made them second guess whether the economy is really coming out of its long slump,” he said.

“This creates a major conflict for employers, with workers getting socked with the higher living costs at a time when they’re slowing down wage increases. It makes it difficult for an employee to keep up with real inflation,” Gavejian said. “It may create a new round of job hopping if workers believe they can get a better deal somewhere else.”

His clients report that inflation is a huge threat going forward. “Employers are looking to

the government to answer the question about oil prices, and the government is giving vague answers that consumers and employers can't grasp," he said. "Speaking of inflation – nobody is talking about Greenspan's departure from the Fed in January. The markets must be uneasy about this, and we expect that this will have some impact on wages next year."

Because some troubled industries have succumbed to bankruptcy to renege on pension obligations, workers have become more suspicious of company retirement plans, he added. "This makes self-administered retirement plans much more attractive to employees, and we'll probably see a higher level of employee contribution to these plans in the future."

But even healthy companies are nervous about the issue of pensions. "I think they all have their bankruptcy consultants waiting in the wings just in case there is some more catastrophic news."

Indeed, Katrina and Rita relief are THE issue of the day. "Most employers have a 'this could happen to me' attitude. That makes employers cautious, and they consider slowing down wage increases, reducing benefits to employees and expanding their business more slowly," he said.

"The irony is that 2005 was shaping up to be a good year. Performance in several industry sectors that we track – insurance, financial services, health care – was turning upward. Employers need to balance the gains that they made in the early part of the year with all of the bad news that hit in September. Even though it might not have affected them directly, they're still cautious."

Steve Gross, worldwide partner for Mercer Human Resource Consulting, feels it is too early to tell what the ultimate impact of higher energy costs would be on wages. "The question is at what level will energy prices stabilize? I have not seen any change in salary budgets because of the energy issue," he said.

The early budgeting for 2006 indicates increases of about 3.5% to 4.0% for most workers. "But the big story is variable pay in terms of increased eligibility and opportunities and payouts," he said. "We expect 2005 to be a good year when the checks are issued early in 2006. Payouts are expected to be at target or greater, exceeding last year's amounts."

But Gross cautions that the wildcards will continue to be the longer-term impact of Katrina and Rita and their "sustained effect on energy prices and their impact on profits and the resultant pressure to raise prices – in other words, inflation..."

David Leach, managing director of ECG Advisors in Los Angeles, sees two telling scripts from today's headlines.

The first is that Delphi Corp.'s top executives, whom hourly workers had criticized for

taking sweetened bonus packages while workers faced drastic cuts, will reduce their annual pay until the [auto](#) parts maker emerges from bankruptcy.

The second is that GM announced a tentative health-care deal with its union that would save the automaker about \$1 billion a year. GM, which posted a \$1.6 billion loss for the third quarter, also said it is exploring the sale of a stake in its GMAC unit. GM also plans more job cuts.

Under the increasingly difficult economic climate, “the winners will be those who can adjust the quickest,” Leach said. “Companies and workers need to think of creative alternatives, such as allowing workers to work more from their homes, provide more flexible work schedules, replacing fleets with more fuel-efficient vehicles and carpooling. Europe has had the high gasoline prices for years, and they have learned to adjust.”

He too sees companies “continuing to be cautious – seeming to delay any actions for as long as possible.”

Companies “are reluctant to vary their salary budgets very far from the competitive norms of three to four percent and bonuses will vary widely by industry and company since they are mostly tied to company profitability,” Leach added. “Bonuses in financial services and energy appear to be increased since those industries have increased their returns and are generally profitable.”

Having said that, “high energy prices are on everyone's mind, contributing to the cautious attitude,” Leach continued. “High energy prices are influencing decisions. Some companies are trying to pass on the extra costs through surcharges. And people making employment decisions based on energy prices.”

Changes in accounting for stock options and increased shareholder scrutiny are prompting companies to review their long-term incentive plans and introduce performance stock plans as they cut back on their use of stock options. “Stock options are being issued to fewer employees and not as low into the organization as in prior years,” Leach said.

Jim Watt, president of Employee Benefit Solutions in Houston, sees prescription drug costs as a resurgent problem. “There are [no](#) specifics here other than, as the whole of the US population is aging, utilization of pharmaceuticals continues to grow with averages reaching 10 prescriptions per family member per year,” Watt said.

Biotech drugs growth is also expected to double in the next 12 to 24 months from 1% to 2% of all drug spending, “and with an average price tag of \$50,000 per prescription annually, the impact to employer plans will be significant.”

Watt, whose clients include Houston energy companies, sees rampant wage pressures regionally. “The wage environment in the Gulf Coast and in the energy sector is well outpacing the national economy, as energy companies are struggling to keep up with

growth demand in the sector,” Watt said. “A common phenomenon, pre-Katrina and Rita, has been job switching driven primarily by wages, but to a lesser extent benefits. Wage inflation is now commonplace and employees are responding. We believe that post Katrina and Rita, hiring will accelerate job switching, as displacement will offer another incentive to shop employers.”

Chris Clarke, president of Boyden Global Executive Search in Hawthorne, New York, sees a continuing surge in pay for top executives. “Bonuses are very high on Wall Street for M&A and in the hedge fund and private equity areas. This is likely to keep the housing market and luxury goods markets in the area high and, therefore, related employment,” he said. The only offset on top-executive pay is greater shareholder scrutiny, courtesy of Sarbanes-Oxley.

At the lower tiers of the workplace, blue-collar workers will suffer the brunt of the pain from energy costs. “Wages in this area are already tight because of the Chinese competition in manufacturing,” he said.

Kerry Chou, practice leader, professional development for WorldatWork, an organization of professional compensation executives, said anecdotal evidence “does not hint of any upward pressure on pay or benefit levels over and above the 3.8 percent projected” projected in its 2006 Salary Budget Survey released prior to the spike in energy costs.

“The impact of high energy prices differs by industry,” Chou said. “The airline industry, for example, has been decimated by rising fuel costs. Other industries where energy is a key factor in production will also experience significant increases in overall costs. Those businesses in the service sector may feel less of an impact,” he said.

“From an employee perspective, increased commuting costs are taking a bigger bite out of household income. Businesses may also need to compensate for increased production costs through reducing budgets in other areas, which may include salary and benefit budgets,” he continued. “At least in the short term, it appears that the only winners are the oil companies.”

The U.S. Labor Department is scheduled to release the Employment Cost Index for the third quarter on Friday, Oct. 28 at 8:30 a.m. ET.

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