

Employment Compensation:

Compensation Execs: US Wage/Benefits Gap Widening

- Pensions Seen Slowly Headed For Extinction
- Top Wages Soar as Lower Rungs Experience Some Downward Pressure
- A Trend of Two-Tier Contracts Where Newest Union Workers Lose Out

By Gary Rosenberger

NEW YORK (EconoPlay) Jan. 26 – Pressures on wages and benefits are flat to down for average workers, sharply higher for the elite, at a time when U.S. companies continue to strive to cost-cut their way into global competitiveness, say compensation specialists.

For Wall Street and top-tier executives pay is soaring – and everybody else can count themselves fortunate if their increases keep even with inflation or, in the case of airline and automotive workers, they have a job at all.

One prominent casualty is defined pension plans, now seemingly headed for extinction as financially troubled companies – and others like IBM, not particularly noted for their legacy costs, reduce or eliminate them.

Health benefit costs, with the exception of pharmaceuticals, are decelerating – but they remain expensive, problematic and far less generous.

On average, however, compensation experts say salary budgets generally call for increases of 3% and 4% annually – leaving workers to fend for themselves in the face of higher costs for fuel, mortgage payments and other inflationary pressures.

For a lucky few, times couldn't be better. Unprecedented bonuses have dramatically widened the gap between the nation's highest and lowest earners, even in the face of new regulations aimed at making executive pay more transparent to shareholders.

Another concern is the implication of two-tier wage agreements whereby the newest and youngest workers enter union jobs under more onerous terms than their predecessors.

“Conditions are changing for U.S. workers – everything is so much more global now. Just look at the Ford cutbacks. It's all because of global competition. Ford isn't losing share to GM or Chrysler, it's losing share to Toyota,” said David Leach, president of Executive Compensation Group in Santa Monica, California.

Leach's overall sense is that companies are sticking to their 3% to 4% salary budgets, but underlying that are convulsive and divisive issues that increasingly put employers at odds with their own workers. “Companies have to adjust and be more flexible. They're trying to keep their labor costs down. That's part of what we're going through right now,” he said.

“Benefits were created to engender worker loyalty, but companies no longer necessarily want their workers to be loyal. That has all changed. Companies now want workers to be replaceable

like machine parts,” Leach added. “Companies can no longer afford to provide defined benefit plans – and workers have to look out for themselves, especially when it comes to retirement.”

At the executive level, the picture is entirely opposite. “We are seeing unprecedented bonuses on Wall Street. They perceive these people to be contributing to Wall Street’s huge profits and they’re paying the price to keep them.”

The irony of new regulations encouraging transparency is that in exposing top corporate salaries to shareholders it also pressures competing companies to match the most outrageous publicly disclosed compensation packages. “These regulations will only work if shareholders take an active interest in the subject of compensation. Generally, shareholders don’t take notice when stock valuations are rising.”

Besides, Leach asks, “How do you define fair? Is it looking at the outside and seeing what other companies are paying their executives, or is it looking inward and paying them something more proportional to the lowest rung?”

At this stage workers cannot expect their bosses to compensate them for the higher cost of a commute. “Companies will not give people more money so they can fill their gas tanks. But they can provide a flexible shift so workers don’t lose time and money in traffic,” Leach noted. “The companies that will survive (the energy shock) are the ones that can be flexible.”

Leach sees pensions as the first casualty, especially among industries operating on the fringes of bankruptcy. But he noted that IBM, a company that is under no such strain, also eliminated its pension plan, signaling a trend that others will be sure to follow. “Defined pension plans are a holdover from the past. I think what IBM did is part of a general trend to do away with legacy costs.”

Steven Gross, employee compensation leader for Mercer Human Resources Consulting, argues pension cutbacks underscore the fact that few people have lifetime careers with one company anymore.

“Companies are now in a mode that they treat workers as transactional rather than encourage a long-term relationship,” he said. “That leaves workers asking how they can create enough wealth so that at the end of the day they can pay for their own retirement.”

Energy costs are a huge issue for companies and workers alike, but so far that has not spilled over into compensation. “Higher energy costs means less money available for salary budgets. So do I find other ways to make my business more efficient? Do I pay my employees less? Or do I raise prices?” he asked rhetorically.

“So far, the answer has been raising prices – usually by way of surcharges on anything from a package delivery to a dry-cleaning bill,” Gross said.

Meanwhile, employees who made an economic decision to live farther away from the workplace now have to pay for the high cost of commuting, as they struggle to make higher

payments on their adjustable rate mortgages. “Will people choose to drive more fuel-efficient cars? Will companies allow people to work from home on Fridays? As for home mortgages, people had a below market rate to start with, didn’t they expect a day of reckoning?”

So far it does not appear that workers are clamoring for higher wages as they’re squeezed by inflation. “I still stick by my 3.6% forecast for 2006. I haven’t heard a lot about companies making substantive changes to their salary budgets,” Gross said.

One reason is that inflationary pressures are offset by job insecurities, especially with the more than 65,000 layoffs announced by Detroit’s Big Three in January. “You have 30,000 layoffs at Ford and that sort of thing cascades,” he said. “It’s a very spotty economy. On one side you have Ford and on the other side you have Wall Street having its best year ever.”

He sees trouble ahead for union workers in light of recent two-tier labor agreements that generously reward older employees as entrants to the workforce take nasty wage and benefits cuts. “This is a dangerous trend. Pay inequities are always disruptive in the long-term,” he said.

Gross likens the employment market to an hourglass. “You have the high-end workers with all that value added and you have low-wage earners that can always get work at Wal-Mart and other service industry jobs. That’s where all the action is because you can’t outsource everything,” he said.

“It’s the part in the middle that I most worry about. That’s where you see the squeeze,” he said. “There was a time when you could get a job in an auto plant with almost no education and still pay for your home and for your kids to go to college. Now these people have no jobs. What are they going to do?”

Meanwhile, health benefit increases have finally backed off from double digit territory, according to one specialist.

“Healthcare costs are beginning to moderate, and we expect that year over year changes in cost will likely approach a high single digit range of 8 to 9 percent for 2006,” said Jim Watt, president of Employee Benefit Solutions in Houston.

But he also sees inflation within the pharmacy component continuing to escalate at a 15% to 17% range, gobbling up a greater share of the healthcare dollar. “The aging population continues to consume more healthcare services through higher utilization, and by buying an increasing number of pharmaceuticals for illnesses that are more complex to treat, at a greater expense,” Watt said.

But he also noted that companies are becoming “cautious” about how much more they can take away from workers through wholesale cuts to plan design or by shifting more cost burdens onto workers.

“We also believe that pension plans will go the way of the dinosaur, as the burden to perpetuate such plans will leave the companies that continue them unable to compete in the global marketplace,” he said.

But another compensation specialist doesn't quite read things that way. “While I did see that Big Blue got rid of defined pension benefits, I think it's too big a political hot potato for companies to just get rid of. I don't see other, financially sound companies getting into that on a wholesale basis,” said Paul Gavejian, president of Total Compensation Solutions in Armonk, New York.

Chris Clarke, president of Boyden Global Executive Search in Hawthorne, New York, described a host of factors contributing to the sharp rise in executive pay, along with countervailing pressures to lower the cost of labor for almost everyone else.

“Executive pay, especially for CEOs – and bonuses on Wall Street – is burgeoning for different reasons,” he said. “CEOs in Fortune 500 corporations last an average of 2.4 years, down from over eight years in the mid 1980's,” Clarke observed.

“Nomination committees want successful CEOs from other firms, so they and their executive search firms need to persuade incumbent CEOs to accept the high risk of moving to the new firm,” he added. “CEOs will only move for a substantial increase in package, and usually negotiate high severance terms for the new role.”

They also face the costs of disruption in their pension plans, insurance and other financial affairs – and “with the global economy in the middle of a likely 7 to 10 year growth cycle, corporations are in hiring mode for senior executives,” Clarke said.

At the same time CEOs are under the gun to reduce overall labor costs. “There is an inverse relationship between increases in CEO and senior executive pay and blue collar, mid level and clerical pay. The more CEOs can reduce their firms' cost bases by replacing high priced U.S. jobs with lower cost labor from developing countries, the more profitable their corporations might be and the higher their own performance related rewards,” Clarke said. “Hence, senior executive pay is decoupled from that for lower level employees.”

The only job categories that are immune from this trend are those that cannot be shipped overseas. “Services that can be supplied effectively from low cost economies like call centers do go offshore, but others from haircuts to auditing and tax advice, two other boom areas, are supplied locally in the U.S.,” he said. Indeed, Clarke's own Kazakhstani barber charged the equivalent of 10 cents a haircut in his home country, but in Westchester County he charges \$20.

On the healthcare front, Clarke sees little hope for cost reductions as long as pharmaceutical companies “keep inventing better and more expensive ways of prolonging and improving the quality of life.”

Corporations, especially those under pressure from low cost economies, “will reduce benefits for existing and especially new employees,” he said. “If they do not, the jobs will go away and there will be no benefits anyway. Facts of life I am afraid.”

Amy Jantz, compensation professional at WorldatWork, a professional association of compensation executives, offered a mixed account of wage pressures. “There do seem to be some starts and stops in different sectors over the last year as the economy has tried to get traction,” she said.

“Wage changes in the short-term did not seem to have much influence related to energy, but wage changes tend to be longer-term and could see some influences in the future if stability doesn't return to that sector for some parts of the workforce,” Jantz said.

She sees large unionized companies downwardly negotiating compensation packages for workers, and two-tier wage agreements are a common result. “This is more an opportunity to rebalance the liabilities of the organization and adjust the expectations of future workers on the wages and benefits that they can expect to receive and remain gainfully employed,” she said.

The U.S. Labor Department is scheduled to release the Employment Cost Index for the fourth quarter on Tuesday, Jan. 31 at 8:30 a.m. ET.

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