



What Compensation Really Costs

Compensation consists of more than just wages. Most obviously, employment taxes and workers' compensation premiums add to the price of labor. Benefits and paid time off also constitute a significant burden. According to data published by the Employee Benefit Research Institute (EBRI) in March, 2005, total costs for private sector compensation rose from \$13.42 per hour worked in March, 1987 to \$23.76 in September, 2004. The Bureau of Labor Statistics found that total compensation costs increased at an annual rate of 3.3% since March, 1987, however, according to EBRI the cost of employee benefits increased 3.7% annually during that time, indicating that the cost of benefits is taking up a larger share of total compensation costs.

Given the drastic increases in healthcare expenditure and premiums in recent years it may be surprising that benefits as a percentage of compensation increased slightly less than 2% over a 17 year span, from 26.8% of total compensation in March, 2005 to 28.6% in September, 2004. Part of the reason the increase appears so small is a period of decline of health benefits as a percentage of compensation costs from 1994 to 1997. In March, 1997 health insurance cost reached a low of \$0.99 per hour worked. However, it has increased steadily since then, reaching \$1.56 per hour worked by September, 2004.

According to the EBRI's data, the proportionate cost of retirement benefits has gone up as well. In March, 1987 defined contribution plans (such as 401(k) plans) comprised 0.5% of total compensation costs. This rose to 1.8% in 2004. This has been offset somewhat by a decline in defined benefit plan (i.e. traditional employer-funded pension) costs from 3.1% of compensation March, 1987 to 1.8% in 2004. This may reflect a general trend away from traditional pensions and toward defined contribution plans rather than a decrease in transactional rates, as well as optimism (often unfounded) about the rates of return companies can expect from their defined benefit plan contributions. On the defined contribution side the increase may be largely attributable to increased participation and employer matching contributions.

What does the future hold? It seems likely that defined benefit plans will continue to wane and defined contribution plans will continue to be popular. The cost of defined contribution plans as a percentage of compensation is likely to remain relatively low. All eyes are on the cost of health care. According to the National Coalition on Health Care, premiums for employer-based insurance rose 7.7% in 2006, approximately twice the rate of inflation, with small businesses being hit even harder; firms with less than 24 employees, for instance, experienced average increases of 10.5%. If such increases continue to be the norm (and there appears to be no brake on the level of national healthcare expenditure), employer-based insurance will become too expensive to maintain. Indeed, many employers have already been forced out of the market.

Employers generally still feel it is important to continue offering health benefits if they can, however they cannot bear infinite increases. They may choose to draw the line at or near their current level of spending and pass increases above their tolerance level to their workforce either directly through increased employee contributions, reductions in coverage, or creative devices such as those using high deductible plans. If this trend gains more momentum it may skew the numbers in the near future; as more and more companies either stop offering health benefits altogether or refuse to increase their spend, it may appear that health care as a percentage of total compensation is increasing more slowly than it actually is. The increase will instead be expressed as a reduction in the real value of employee wages as employees bear the brunt of increases. Given that wage increases tend to lag behind inflation, this unfortunately will hit workers doubly hard. Health coverage at a reasonable cost, if it can be found, is likely to become an increasingly valuable benefit for attracting and retaining employees.