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America in Transition: Implications for Employee Benefits

AN EBRI-ERF POLICY FORUM

Employee Benefit Research Institute

The Employee Benefit Research Institute (EBRI) was established in 1978 to contribute to the development of effective and responsible public policy in the employee benefit field. EBRI is a tax exempt trade association with the overall goal of promoting the development of soundly conceived private and public employee benefit plans.

A nonprofit organization, EBRI sponsors and conducts research in the employee benefit field. It publishes research results and other information on employee benefits and sponsors lectures, forums and workshops. By acting as an information clearinghouse, EBRI helps to provide private and public sector decision makers with useful information.

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America in Transition: Implications for Employee Benefits

Edited by
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Table of Contents

Foreword

Our nation is in a period of transition. Attitudinal changes along with dramatic shifts in family relationships, life-styles, work-styles, trends toward earlier retirement and increased longevity have far reaching implications for *all* organizations sponsoring health, welfare and retirement benefits.

Through Social Security and other private and public income and health benefit programs, most Americans are affected by our national employee benefit policies. These policies affect our taxes, household income, overall welfare and economy. They also have substantial influence on the future productivity of our work force.

The following changes are examples of social and economic trends that have broad implications for private and public programs:

— In recent years, the U.S. population has placed an increased emphasis on immediate personal gratification and they have developed an expanded interest in public and private entitlement programs.

— We have experienced rapid increases in female labor force participation. The participation of women in the labor force was 37.7 percent in 1960 and 51.6 percent in 1980.[1]

— From 1970 to 1980, one-person households nearly doubled. This resulted from two trends: (1) more young people delayed marriage; and (2) the divorce rate rose dramatically. Furthermore, single-earner families have increasingly become single-parent households. In 1980, 20 percent of the 61.7 million children who were under age eighteen were living with only one parent.[2]

— By the late sixties, the baby boom generation was entering the work force. This combined with the influx of female workers resulted in a substantial increase in the overall work force size and composition. In the 1970s, the work force grew at an unprecedented annual rate that exceeded 2 percent.

— As life expectancy continues to increase and average retirement age continues to fall, the retired population is gaining size and requiring large financial outlays from Social Security and employer pension programs. For example, in 1950, only 20 percent of elderly households received Social Security benefits and less than 10 percent received employer pension benefits. Approximately 40 percent of men aged sixty-five and over worked. Alternatively, in 1980, over 90 percent of elderly

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[1]See the following paper on "Changing Family Roles: Their Impact on Benefit Programs" by Yung-Ping Chen.

[2]Ibid.

households received Social Security and over one-third received employer pensions. Twenty percent of men aged sixty-five and over worked. Since 1950, the average real Social Security benefit has increased by a factor of 3.[3]

— Health care costs have escalated. During the seventies, the Consumer Price Index (CPI) rose 87 percent while medical costs doubled. This has directly affected the costs of public and private health insurance programs. For example, between 1966 and 1981, annual payments provided under Social Security's Health Insurance (HI) program increased by a factor of 35. Furthermore, HI spending is projected to grow annually at an average rate of 15 percent—reaching at least $99 billion by 1990 and $448 billion by 2005.[4]

— Employers have traditionally provided pension benefits through defined benefit programs. However, in the last decade, there was a substantial growth in defined contribution plans and individual savings plans, e.g., thrift plans. If this trend continues, it could have significant implications, since it may shift the placement of risk from the employer to the employee.

Today, health, welfare and retirement benefits comprise more than 50 percent of federal government expenditures, an increasing share of state and local government expenditures and up to 48 percent of private employers' compensation costs. At a time when the retirement population is expanding rapidly and we are faced with rising unemployment and an escalating budget deficit, it is important to design realistic, efficient benefit programs. The next twenty years will be a particularly challenging period for business managers and policymakers. Human resource management and the financial security of employers as well as employees will be prominent issues.

With these concerns in mind, the Institute has undertaken a program of research and education based on the theme *America in Transition: Implications for Employee Benefits*. Our November 10, 1981 policy forum, "The Effects of Changing Family Relationships on Employee Benefit Programs," and this publication, represent the first products of this effort.

The papers presented in this volume discuss the changing attitudes of employees and employers with respect to employee benefit needs.

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[3]Employee Benefit Research Institute, *Retirement Income Opportunities in an Aging America: Income Levels and Adequacy*, Executive Summary (Washington, DC, 1982), p. 4.

[4]Employee Benefit Research Institute, "U.S. Spending for Health Care Lower for Rich than Poor," *EBRI Notes*, vol. 3, no. 1 (Washington, DC, 1982) p. 4; idem, "The Burden of Saving Medicare," *Issue Brief*, no. 6 (Washington, DC, 1982).

The discussion is set within the context of our nation's ongoing economic and demographic shifts.

The Institute thanks our November policy forum speakers and participants for their substantial contributions to this publication. We are also grateful to the Weyerhaeuser Foundation for partial funding of the forum.

DALLAS L. SALISBURY
Executive Director

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Florence Skelly is President of Yankelovich, Skelly & White, Inc. She has initiated and developed: (1) *The Laboratory Test Market*, a pioneering effort in test market simulation; (2) *Monitor*, a business service which measures and tracks the impact of social change on consumer goods marketing; and (3) *Work Values Signal*, a continuing study of changing work values and employee motivations. Ms. Skelly is a member of the American Marketing Association and Advertising Women of New York. She is also a Seminar Fellow at Columbia University and she has been elected to the Hunter College Hall of Fame.

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Changing Values and Their Effect on Employee Attitudes, Expectations and Requirements

Florence R. Skelly

I would like to start off this afternoon's session by sharing with you some of our findings regarding the social values outlook for the 1980s. Hopefully, this will set a context for the more specific discussions to follow on *America in Transition: Implications for Employee Benefits*.

Yankelovich, Skelly and White has been tracking changes in people's values and attitudes in the United States for about a dozen years. We do this in three contexts. First, we look at changes in social values as they affect the way people spend their money—an area of profound interest to marketers. We also look at changing values as they impact public policy pressures. And finally, we look at changing values as they affect employee attitudes, expectations and requirements.

I would like to share some findings with you which represent a distillation of hundreds of thousands of statistics. But first, let me give you a backdrop on what we see emerging for the 1980s, in terms of what are essentially worker attitudes.

If you look at the decade of the 1950s in terms of societal goals and means, this was a decade when the goal almost universally supported in this country was to achieve upward mobility. Each successive step on the ladder was signaled through the acquisition of material goods—materialism.

The means for achieving this has been described as the protestant ethic or the puritan tradition. It centers around the notion of self-denial—denial of individuality in favor of conformity; denial of whim in favor of duty; denial of current desire in favor of the future.

In the 1960s, we began going through a period that has been variously described as wrenching or profound or extreme. It was a period of real social change. In essence, our goals have moved from materialism to the notion of self-fulfillment—finding out the kind of person you were meant to be. Achieving this was the ultimate in happiness.

This is an edited transcript of Ms. Skelly's informal introductory remarks at EBRI's November 10, 1981 policy forum.

Failing this, a substantial portion of the culture moved to what has been described as a pale version of hedonism—a search for the maximization of experience for the full rich life. This is quite different from the original version of fulfillment.

How to get there? Through the assumption of universal entitlement and an almost unceasing focus on the self. Introspection, finding out what *I* want, what *I* was meant to be. This is the antithesis of the self-denial focus of the fifties.

Our work suggests that the eighties will be different. The 1980s will not be a continuation of fulfillment, full rich lifism and focus on self. I would like to cite three reasons for this.

The first reason this decade will be different is *aging*. I'm talking about the post-World War II baby boom cohort, moving into their mid-thirties, with all of the things that this implies about confrontation of their own mortality, physiological deterioration, etc. In the presentations that follow, there will be a great deal of discussion about aging and what this is doing to our country.

The second reason that the eighties will be different is a new kind of *economic realism*. The value changes of the sixties grew out of a psychology of affluence, a belief that America's economic future was almost infinitely expandable. Over the last several years, the work of our firm and others who measure the public's ideas, uniformly shows that we are pretty uncertain about our infinitely expanding economic pie. We are not sure that we will be number one. We are not sure that future generations will live better than those who lived in the past. In general, there is what you might call an economic maturity that has set into the public thinking. We are becoming more like Europe. Surveys show that Europeans know that things are not going to get better year after year. In fact, they believe things will get worse. We are not quite like that, but we are uncertain that the economic pie is infinitely expandable. This has a real effect on people's values.

The third reason that the eighties will be different is because we are reacting to *new values*. The new values of the sixties and seventies have been around for twenty years—a long time. A lot of the people who started them, the baby boom cohort, are now older. They have lived through twenty years of experimenting with new life-styles, new beliefs, new goals, new ideas. They are beginning to shift and change, keeping some new values and giving up others.

In this context, there are five general social thrusts that our work shows to be on the rise. I think these are a relevant backdrop for the more detailed employee benefits presentations that follow.

First, we are finding that people now have a more selective view of entitlement. The notion of universal entitlements is now on the decline. We find an erosion of the egalitarian spirit, a growing acceptance of meritocracy. In point of fact, we seem to be moving in the direction of a culture that is more supportive of justice than of mercy.

Second, there is a shift in people's expectations from government to business. The country is now supporting a reduced role for government as an agent of social change—even for granting entitlements or for helping those in trouble. People are looking more and more to business as a gap-filler.

The public's demands on business are enhanced by increasingly positive attitudes, which the public holds towards business as an institution. Since people are more favorably disposed toward business, they are more willing to see business in a gap-filler role. For instance, one of the areas where business will be more active is through more programs for employees.

Third, there is a revival of support, at least in spirit, for the idea of free enterprise, large profits and the entrepreneurial approach. One could say that the country increasingly believes that our economic pie is not infinitely expandable and that American hegemony is not assured. We want to go back to support of free enterprise and profits. We want our companies to do well.

Fourth, there is a return of faith in technology. In the early days of the sixties' new-values revolt, there were challenges to the idea of materialism as a goal. In the minds of the new-values adherents, materialism and technology were closely linked. We went through a period of rejecting technology and favoring a return to nature. Those of you who know marketing, know that we marketed everything with natural ingredients and the natural look. The lemon, for example, became a symbol of the natural as opposed to the highly technological.

Now we find that the return to nature and the natural look is starting to wane. People are becoming more and more responsive to technology as a way of simplifying life and reducing stress. Most importantly, it is a way of bringing individualization into our lives—primarily through the home technologies which permit individually customized kinds of entertainment vehicles and ways of doing business. Thus, rather than viewing technology as a force for conformity, people are seeing technology as a mechanism for insuring individualization or personalization.

Fifth, we find in the country a renewed focus on the future that is characteristic of the 1950s. There is less support for the idea of living for today and living life for the moment. There is more interest in the future. In part, this appears to be a function of the moving into middle age of the very large baby boom cohort. We also find less labor force interest in immediate mobility—the willingness to just drop everything and pursue immediate gratification.

Over and above these five social thrusts that are somewhat different from the thrusts of the last two decades, there are two crucial continuities that are derived from the new values of the sixties. First is a continued commitment to pluralism, to flexibility, to individualism. The whole idea of an aggressive support for pluralism grew out of the sixties' focus on self, where you found out through a $3 billion introspection industry who you were; you realized how different you were; and, therefore, you assumed that everybody else was also different. We began to really extol the value of pluralism. This is still continuing.

Second, the support for a different kind of family structure and a different role for women—which has brought us the two-earner household, female careerism, the blurring of sex roles, delayed childbirth, lower fertility rates, etc.—continues.

These seven trends—five that are emerging for the eighties and two that are continuations of the new values of the sixties and seventies—suggest that we are looking forward to a different kind of general public and employee climate in the decades of the eighties.

Our work among employees directly shows that they expect personalization for individual needs and requirements; that they want to be recognized; that they want to feel they can communicate with their employers without penalty; that they can describe some special individual need without, in any way, hurting their future work life; that they support fairness, but do not go beyond fairness; and that they want flexibility in their hidden contract with their employer. Workers do not want anything engraved in stone forever. Instead, they want the freedom to change arrangements along with the changing milestones that accompany their life cycle.

These comments offer a backdrop for the far more detailed papers that follow. These papers explore the future and the effect of new family relationships on Social Security and employee benefits. They also discuss the approaches of some companies that have attempted to respond to their employees' changing needs and values by developing new benefit packages.

Changing Family Roles: Their Impact on Benefit Programs

Yung-Ping Chen

Changes in marriage and the family, living arrangements and labor force behavior during the last two decades may be captured from a brief recitation of some statistics.

Delay in First Marriage—In 1950, the median age of first marriage was 22.8 years for men and 20.3 years for women. By 1970, the age was 23.2 for men and 20.8 for women and by 1980, 24.6 for men and 22.1 for women. The proportion of women who were between the ages of 20 and 24 and had never married was 28 percent in 1960; this increased to 50.2 percent in 1980. The proportion of young women between 25 and 29 years of age who were single nearly doubled from 10.5 in 1960 to 20.8 in 1980.

Average Family Size—There has been a steady decline in the average family size. During the early 1900s, the average family had 4 children; during the 1930s, 3 children; during the 1950s, 3.5 children; during the 1960s, 2.5 children. According to most observers, the average number of children born per woman will probably remain at 2.1 in the years ahead.

Divorce, Remarriage and Separation—The divorce rate increased dramatically in the last two decades. From 1960 to 1980, the divorce rate more than doubled from 2.2 to 5.3 per 1,000 population. For every 1,000 married couples who lived with their spouses, there were 47 divorced persons in 1970 and 100 such persons in 1980.

The remarriage rate has moved down in recent years; from 1972 to 1975, it declined by 17 percent. The number of divorced persons remaining single has more than doubled from 1.5 million in 1970 to 3.4 million in 1980. Even the remarriage rate after widowhood went down—in 1975 it was 2.5 percent less than in 1972.

Separation has become more prevalent as well. In 1976, the number of separated persons was about half as large as the number of divorced persons—3.8 million as compared to 7.2 million.

One-Person Households—One-person households more than doubled from 1970 to 1980: 11 million as compared to 18 million. Of the

18 million one-person households in 1980, approximately 11 million were headed by women.

Children in One-Parent Households—One result of the continuing high divorce rate is that there is an increased likelihood that children will not be living in a home with both parents. In 1980, there were 61.7 million children under age eighteen; 77 percent of them were living with two parents, as compared with 85 percent in 1970. The proportion of these children living with only one parent was 20 percent in 1980, compared to 12 percent in 1970.

Of all families in 1975, those maintained by a woman without the presence of a husband comprised 13 percent; this was up from 11 percent in 1970. In both years, only 2 or 3 percent of families were maintained by a man without a wife present. From 1970 to 1975, married-couple families increased by only 6 percent, but single-parent families went up by 30 percent. In 1975, more than 60 percent of the single-parent families headed by women had one or more children living with them.

Living Together Without Being Married—Unmarried couples have nearly tripled since 1970. In 1970, there were about 523,000 households shared by two unrelated adults of the opposite sex; in 1980, 1,560,000 households were shared by such adults. About 75 percent of these households in 1980 consisted of two adults only and the remaining 25 percent consisted of two adults and one or more children who were younger than fifteen years old. Most of the growth in such households during this decade has been among those with no children present.

Despite the impressive increase in the unmarried-couple living arrangement, the 3.12 million partners in these 1.56 million households represented only 3 percent of the partners in all *couple households* in 1980 and only 2 percent of all households.

The changes in family relationships and styles of life and work described above have far reaching implications for the private and public institutions providing economic security. For example, because Social Security is a valuable economic-security mechanism to families, reductions in family size and growth in living arrangements involving persons in single situations tend to make Social Security less valuable—or at least perceived as less valuable—to an increasing number of persons. Another example is in the area of employee benefit programs. The traditional model of the household unit for employee benefit programs is a family consisting of a "bread-winning father, bread-making mother and bread-eating children." When this style of living no longer represents the typical family in the economy, the design of employee benefit programs as well as of Social Security and other related economic security devices will need to adapt.

Employment Pattern of Women

Changes in family relationships and the labor force behavior of women are two phenomena that interact with each other. The civilian labor force in 1980 was just under 105 million persons. During the past twenty years, women have been responsible for almost 61 percent of the growth in the civilian labor force. The number of female workers in 1980 reached 44.6 million, which represented an increase of about 21 million since 1960. Over the same period, the male civilian labor force increased by only 14 million.

During the 1970s, a record number of women entered or reentered the paid labor force. Labor force participation of women was 51.6 percent in 1980, rising from 37.7 percent in 1960 and 43.3 percent in 1970. Put another way, for every 100 women in the total working-age population, there were 14 more in the 1980 civilian labor force than there had been in the 1960 civilian labor force.

Based on a recent current population survey, the Bureau of Labor Statistics has reported the following highlights of labor force characteristics in March 1980. From March 1970 to March 1980, the proportion of the labor force composed of married persons living with their spouses fell from 69 to 61 percent. Alternatively, the share of never-married and divorced persons increased from 24 to 33 percent. The gradual transformation of the marital composition of the labor force reflects major demographic and social changes that have occurred during the 1970s. For example, half of the more than 20 million increase in the labor force during the decade was among persons twenty-five to thirty-four years old, who now account for more than 1 of every 4 workers. Many of these workers, born during the post-World War II baby boom, tended either to postpone marriage or not to marry. Those who did marry were more than twice as likely to become divorced than workers of the same age ten years earlier. The result is that only 65 percent of workers twenty-five to thirty-four years old were married in March 1980, down from 79 percent a decade earlier. There are several other findings from the survey that are of interest:

(1) Over the decade, the number of married women in the labor force grew by nearly 6 million. By March 1980, 24.4 million wives were working or looking for work.

(2) About 17.5 million or 56.6 percent of all women with children under eighteen were in the labor force in March 1980. Although mothers of school-age children were more likely to be in the work force than those with children under six, the number of working mothers with preschoolers increased dramatically.

(3) One of every 5 mothers in the labor force, or a total of 3.8 million, was maintaining her own family. Mothers in one-parent families had a much higher labor force participation rate (67 percent) than those in two-parent families (54 percent). Even when children under age six were present, 55 percent of the mothers maintaining their own families were in the labor force, compared with 45 percent of wives with children under age six.

(4) In March 1980, 30.7 million children under eighteen, or 53 percent, had mothers in the labor force. This compares to 25.5 million, or 39 percent, who had working mothers in 1970. By March 1980, 43 percent of all youngsters below age six had mothers in the labor force, compared with 29 percent at the beginning of the decade.

In contrast to the rising female labor participation rates, the overall civilian labor force participation rate for males declined—from 83 percent in 1960 to 80 percent in 1970 and 77 percent in 1980. Some of the reduction in male labor force participation rates resulted from the aging of the population.

The increase in female labor force participation more than offset the decline in male labor force participation, however. During the 1970s, the overall labor force participation rate—male and female combined—experienced an increase.

In terms of the work status of household heads and spouses in husband and wife families, the changes between 1960 and 1975 were as follows:

(1) two-worker husband and wife families increased from 23 percent to 30 percent of all households;

(2) no-worker households increased from 20 percent to 26 percent of all households;

(3) one-worker households decreased from 57 percent to 45 percent of all households because of two opposing trends:
— a large decline in one-worker husband and wife households, from 43 percent of households to 25 percent;
— an increase in one-worker households and other types (female heads, and men and women living alone) from 14 percent of households to 20 percent.

In 1980, most working women had part-time, part-year jobs or they had worked intermittently over a period of years. Working wives contributed only about a quarter of all family income. Average incomes of female-headed families and of women living alone were much lower than those of men, even in households where the women worked full time.

Recent trends toward year-round, full-time and continuous work, especially among younger women, will lead to more women working full time more continuously and, therefore, to increased contributions from women to the family finances.

Most social demographers look to a future very diverse in family relationships and styles of life and work. Households will become smaller and the types of households will change more often. There will be more two-worker households and more households of men and women living alone than husband-wife households with one worker. These projected changes indicate that there will be great diversity in the types of households and their differing demands for private and public economic security devices, as well as for public and private goods and services in general.

In the future, as people move from youth to old age, they will experience more diversity in their life- and work-styles. They will spend fewer years in conventional nuclear families and more years living apart from close relatives. In short, people will have more complicated family histories or living arrangement patterns and more complicated sets of relationships from one stage of life to another. This is an important point to keep in mind in revising or designing public and private economic security mechanisms.

Changing Family Relationships and Social Security

Meaning of Social Security to Families—Social Security is not only an income-replacement program for the retired workers who are covered, it also is a source of income for eligible disabled workers. As such, Social Security means a lot to these workers' families, because the benefits provide these families with some measure of economic security. Social Security means more to these families than just payments to the retired or disabled worker, because cash benefits are also payable to eligible dependents and survivors of retired and disabled workers.

Although Social Security is a basic retirement income program, only slightly more than half the beneficiaries are retired workers. Because of the financial protection it provides even before retirement, Social Security is an important economic security measure for workers and their families.

The projected increase in spouse and children beneficiaries is considerably less than that in retired and disabled worker beneficiaries. The projected changes in Social Security's beneficiary categories reflect changing social, demographic and economic trends concerning marriage, divorce, living arrangements and labor force behavior, as well as fertility and mortality.

The Singlehood Phenomenon—Because of the various changes in family structure, Social Security tends to be—or is perceived to be—less valuable to an increasing number of persons who are in either a single state (never married, separated, divorced or cohabiting) or a singlehood mind (contemplating separation or divorce). One way to illustrate this tendency is to consider the question of *money's worth* of Social Security.

The money's worth question refers to the relationship between the benefits to be gained and the taxes to be paid by covered workers under Social Security. The payroll tax rate (applied on wages and salaries up to the taxable ceiling) is uniform for all covered workers, with a separate uniform tax rate for all self-employed persons. Single men and single women pay the same tax rate as married persons pay. Married persons with dependents and those without dependents also pay the same tax rate. Taxes among persons vary only as their earnings do (up to the maximum taxable ceiling). If earnings from employment are the same, workers pay the same taxes but are entitled to different amounts of benefits depending on their marital status and number of dependents. Moreover, a working wife who pays Social Security taxes is eligible to receive either her own retirement benefit *or* a wife's benefit—but not both.

Over the years, there have been differences in the Social Security benefits paid: between single persons and married persons; between married persons with children and those without; and between married couples with working wives and those without. Such differences were not important when the great majority of adults had a lifetime marriage with children, and most married women were not in the labor force or were not in paid work as a career. However, in a world in which singlehood is becoming the life-style of increasingly large numbers of persons, this problem has become more prominent. In addition, since so many women have joined the labor force, differences in the Social Security payout have taken on new significance.

It is suggested that the singlehood phenomenon has created a measure of dissatisfaction with Social Security. Single persons (never married men and women) might feel that they are not getting their money's worth because married persons are garnering high payouts under Social Security. They might feel this way even if they may later marry. Divorced men might feel disenchanted with Social Security for the same reason, even if remarriage may ensue. They might even feel that the taxes they paid while married were wasted, even though their ex-wives may be eligible for benefits. Separated men might be in a like mind, even though marital reconciliation may occur or, in case of eventual divorce, their ex-wives may be eligible for benefits.

The same sort of concern is relevant for the consideration of benefits under employee benefit programs by workers in different categories of marital status.

Alleged Unfair Treatment of Married Women—With the increasing participation of married women in the labor force, many criticisms have arisen with regard to how women fare under Social Security. Alleged charges of unfair or inadequate Social Security treatment of married women may be described or dramatized as consisting of these types of penalties: (1) penalty for working; (2) penalty for divorce; (3) penalty for widowhood; and (4) penalty for homemaking and/or childrearing.

Penalty for working refers to these problems: (1) since a nonworking or homemaking married woman would receive a wife's benefit based on her husband's earnings credits, a working wife may feel that she is no better off for the taxes she pays into Social Security; (2) a man and wife who both work (a two-earner couple) receive less in benefits than a couple with only one spouse working when total earnings of the two couples are identical; and (3) the surviving spouse of a two-earner couple gets less in benefits than does the surviving spouse of a one-earner couple when total earnings of the two couples are identical.

Penalty for divorce refers to these problems: (1) a divorced wife or a surviving divorced wife has no Social Security protection based on her ex-husband's earnings credits unless their marriage lasted for at least ten years; and (2) a divorced wife does not receive benefits until her ex-husband retires, becomes disabled or dies.

Penalty for widowhood refers to the problem that no benefits are payable to a widow under age sixty unless she is either at least age fifty and disabled or is caring for a child or children of her deceased husband.

Penalty for homemaking and/or childrearing refers to these problems: (1) a nonworking or homemaking married woman is not insured against disability, and her survivors are not entitled to benefits when she dies; (2) when a woman takes time out from paid work to raise a family, she loses disability income protection if she does not meet the *recent work* requirement (twenty quarters of coverage in the forty-quarter period ending with the quarter in which disability occurs, with fewer required quarters of coverage for persons under age thirty-one); and (3) when a woman takes time out from paid work to raise a family, her working career is shortened, her lifetime average-earnings credits are reduced because of many zero-earnings years and, as a result, her retirement benefits are smaller than if she had not had children.

While none of the problems cited are the intended results of deliberate Social Security policy, and several of those problems have been created by circumstances external to Social Security, treatment of women has been an important issue confronting the nation's basic program of income support in the event of old age, disability or death. In recent years, several government bodies have been engaged in extensive studies of this issue. There is no indication at this time whether changes will be mandated by Congress.

Protection for Women in the Existing System—Meanwhile, it appears important to call attention to the fact that under the existing system, working wives are earning valuable credits toward disability benefits (in case of permanent and total disability), survivors benefits (in case of death with eligible survivors) and retirement benefits (in case of retirement earlier than woman's husband).

Since women's earnings are lower than those of men, some working women will become eligible for larger wives' benefits than workers' benefits. (The differentials in median earnings between men and women both as year-round, full-time workers have been around 60 percent for years; 58 percent in 1939 and 60–61 percent in May 1978.) Because a working married woman can only receive the larger of two types of benefits, it might easily be concluded that she has paid Social Security taxes in vain. However, the working woman is earning credits toward valuable income protection.

As more women work, they will be acquiring credits toward Social Security retirement benefits based on their own earnings. The Social Security Administration has estimated the distribution of persons receiving old-age benefits derived from their own work records. In 1980, women accounted for some 46 percent of all old-age beneficiaries; this is estimated to reach 56 percent in 2050. Women will make up more than half of retirement beneficiaries in just two decades, by the year 2000. In absolute numbers, women recipients will increase by 5.3 million in twenty years, from 8.9 million in 1979 to 14.2 million in 2000. The longer term growth is even more dramatic.

In addition to retirement benefits, women are also eligible for disability benefits. The Social Security Administration has estimated the distribution of disability benefits between male and female workers in selected years, 1958–2050. The proportion of disability beneficiaries represented by women workers has increased in the past and is expected to grow in the future. When such benefits were first paid in 1958, only one in five beneficiaries was a woman worker. Twenty years later, in 1978, nearly one of every three beneficiaries was a woman. This proportion is projected to rise to 35 percent in 1990, 38 percent in 2000 and 41 percent in 2020–2050.

In absolute numbers, disabled women workers receiving benefits registered a near twentyfold growth in the twenty years between 1958 and 1979. Alternatively, disabled male beneficiaries increased some elevenfold, a considerably smaller rate. The growth rate from 1978 to 2050 is expected to triple for women and double for men. Thus, increasing numbers of women workers will be receiving disability benefits. This is an important protection.

Changing Family Relationships and Employee Benefits

Just as the changes in family relationships and life-styles and work affect the financial outcome of, and the public's attitudes toward, Social Security, they influence workers' receptivity of traditional employee benefit programs.

Conventionally, employee benefits have been organized for the typical family of a father who works, a mother who does not work outside the home and several children. Changes in the family structure and employment patterns have made the *typical family* inaccurate as a generalized model for providing important noncash forms of compensation. Conventional employee benefits designs have not adapted to changing life-styles, such as persons living alone (single, separated, divorced), or changing work-styles, such as two-earner households.

As a result, some employee benefits are duplicative and costly. In recent years, there has been a slight trend toward offering employees menus of benefits from which they can choose the benefits best suited to their changing needs. Under *cafeteria* plans, workers are given a choice among different types and amounts of employee benefits beyond certain basic provisions that every worker must have. Therefore, as examples: two-worker families can eliminate redundant medical coverage; nondrivers can refuse group automobile insurance; older workers can elect out of group orthodontia and other benefits intended for young families; and single female workers can delete maternity coverage. With greater flexibility, employers should be able to satisfy employee needs without offering every benefit to every employee.

Employee Benefits: Adjusting to Future Change

Geoffrey N. Calvert

Before trying to visualize the trends affecting future employee benefits, it is necessary to consider the more basic changes that seem likely to reshape our society and economy in the coming decades. We should consider, for example:

— the microelectronic revolution;

— biotechnology;

— demographic surges;

— resource depletion;

— the sociological upheaval;

— displacement of consumerism by economics;

— inflation, interest rates and capital formation;

— impending rejection of the *social contract;*

— some far-out trends and possibilities.

Each of these will profoundly affect the benefit patterns of the future. They are not independent of each other. The tapestry of the future will be shaped and colored by the interweavings of these forces of change. Nothing will remain unchanged. Those who can adapt best will survive.

The Microelectronic Revolution

> No, sir. The Americans have need of the telephone—but in England, we do not. We have plenty of messenger boys.
>
> —English engineer, 100 years ago

> The modern era of electronics has ushered in a second industrial revolution. Its impact on society could be even greater than that of the original industrial revolution.
>
> —Committee of the National Academy of Sciences

As each year has passed, and as the speed, power and memory of these microprocessors have advanced rapidly, their cost and energy needs have shrunk to miniscule proportions.

Already they gather and process data, prepare summaries and statements, compute, draw graphs and engineering designs. They control typewriters, printers, accounting machines, cash registers, traffic lights, sensing instruments and flow controls.

Incorporated in automatic machines and robots, they control the sequence and timing of cutting, welding, drilling, stamping and painting operations, thus eliminating the need for human guidance of tools and machines.

Knowing no fear, no weariness, no need for coffee breaks or sick calls, no need for vacations, pensions, study sessions, water fountains, rest or recreation facilities; immune to noise, heat, radiation, passion, fumes, vapors or government regulations; able to work patiently for two shifts, or even three shifts each day, seven days a week if necessary; the modern industrial robot is on its way to displacing blue-collar workers right out of the factory. With *up-time* of 95 percent as compared with 75 percent for human workers, with no spoils, as compared with a margin of spoils, with a level of precision and uniformity unattainable by the human hand, a typical robot may cost $4.50 or $5.00 per hour to operate, which is only a third or a quarter of the hourly cost of the blue-collar worker.

Robots are rapidly becoming smarter, more versatile and cheaper relative to human labor. They can be quickly reprogrammed to do different tasks by the mere insertion of a card or disc, thus accommodating product variations, small firms and specialty items.

In Japan, which has become the world's leading producer of robots and components, robots are working twenty-four hours a day producing robots, while automobiles are being almost wholly assembled without human intervention. The latest robots can touch, see and hear. They are able to handle delicate jobs such as camera, computer and watch assembly.

While the microprocessor and automation have called a whole new industry into existence that could open up a million jobs this decade, there will inevitably be widespread labor displacement.

— In its 1975 annual report, NCR Corporation noted that production of the electronic cash register requires only 25 percent of the labor previously needed; hence its U.S. work force was cut from 37,000 to 18,000 with similar reductions abroad.

— The Swiss watch industry lost 46,000 jobs and seventeen firms went bankrupt as electronic watches made in Japan and the U.S. displaced earlier mechanical watches.

— Printing employment has fallen drastically under the impact of computerized typesetting.

But all of this is only an early beginning. Soon robots will be everywhere and the microprocessor will have transformed many other aspects of life and work.

In the coming decades, a universal, personal, pocket-sized, handheld accessory will be more important in our lives than the clock, telephone, typewriter, television, calculator, recorder, copier, checkbook, camera, mail, books or files because *it will replace all of these things*.

Many familiar products, services and occupations will be eliminated; many others will be transformed.

The microprocessor has a devastating potential impact on the market for future job skills. Perhaps one-half of all occupations will in due course cease to exist. Society faces a great occupational upheaval. Skills directly associated with the microprocessor and its applications will be in short supply. Computer literacy will have to be imparted from childhood.

Just as workers migrated from farms to factories a few decades ago, so now they are being displaced from factories as total industrial employment in the western world is already heading downwards under the impact of the microprocessor, in spite of expanding overall production. Not all who are displaced are able to find work in the emerging knowledge industries.

A decade from now, computer terminals at home will be capable of enabling more than 20 percent of all work to be done without commuting to a distant work place. *Communal work clusters* will cater to those without fully equipped home computers, as the microcomputer industry itself becomes the leading industry in the world.

All of this raises fundamental questions as to:

— the obligations of employers to workers;
— early warning of labor displacement in specific industries;
— retraining of workers about to be displaced;
— the hours (and years) of work expected of people;
— how to use the vast amount of leisure created by automation;
— channelling of all the energy released by the liberation of people from having to work;
— how the products of industry are to be distributed, with paychecks to human employees (consumers) no longer flowing.

If employee benefits are looked at as one of the forms of compensation for work, and if work itself is taken over by robots, which need no benefits, or is eliminated in other ways by this dazzling new technology, what then is to become of the concept of retirement, or dependency or incentive programs?

Clearly, retraining programs—both to keep up with emerging new technologies and to move to other fields of employment—will assume enormous importance.

Just as the problem of distributing the products of automated industry will call for a fundamental new approach to putting purchasing power in the hands of potential consumers, so also will the provision of fringe benefits. (Fringes to what?)

Let us hold these questions in mind as we move on to the next source of change.

Biotechnology

Variously referred to as genetic engineering, biotechnology, molecular cloning, and gene-splicing, the development of recombinant DNA technology has now placed in the hands of the human race the power to alter the very forms of life itself. Microbiologists and medical researchers around the world are racing to be first with applications of this new technology.

More than 2,000 diseases are believed to be of genetic origin and open to attack by this powerful new approach. Even normal growth and aging come within its scope. Already, rapid progress has been made in the development of new drugs and treatments, including human insulin, interferon, thymosin alpha-1, somatotropen, urokinase, beta-endorphine and genes to make cells resistant to anticancer drugs. Target-seeking monoclonal antibodies, to strengthen the body's immune system, have greatly improved the prospects for anticancer treatments that will not destroy normal cells; also for overcoming various infections and poisons, as well as the rejection of transplanted organs.

As for interferon, Mathilde Krim of the Memorial Sloan-Kettering Cancer Center had this to say:

> What other substance, at so early a stage in its development, has shown so much promising activity against different—often highly resistant—strains of cancer? And can anyone name another cancer therapy that has shown so few side effects—all of them apparently reversible?

The applications of the new technology are by no means limited to the medical field. Many agricultural and industrial processes are beginning to undergo radical revision also. These range widely from the improvement of livestock strains and conquest of animal diseases, to pollution control and the extraction of metals from ore bodies by bacterial means, to oil from tight formations and tar sands. Proteins, fuels and new plant forms will be able to be created quickly and inexpensively as the new technologies get under way.

A Canadian firm, Bio Logicals, has combined the microprocessor and recombinant DNA technologies to produce a DNA synthesizer that enables even an untrained person, at the touch of a button, to assemble pieces of DNA to make any desired combination. The resulting DNA sequences can be inserted into existing genes or used to make entirely new genes and, hence, new forms of life.

So far, the results of all this work, said to be "the most intellectually compelling, exciting and promising" among all the aspects of biology and perhaps all the sciences, seem to have been beneficial in the sense of overcoming disease, adding to needed products and resources and improving conditions in other ways.

Without question, one of its results will be an extension of human longevity. With much disease wiped out, robust good health maintained far into the later ages and perhaps even the aging process itself slowed down, we can expect dramatic changes in the outlook for family life, work, education, pensions, insurance and other economic and social affairs.

— The number of people at the later ages will swell enormously in relation to those at the younger ages.

— If the *natural limit of life* (about age 110) remains unchanged, far more people will reach or even exceed it. It may be extended drastically.

— If the *normal retirement age* under pension plans, or benefit commencement age under Social Security, remains at age sixty-five, then pensioner populations will swell and pension and Social Security costs will increase drastically and unacceptably. Obviously, adjustments will have to be made in retirement ages.

— People will repeatedly outlive their skills as continuing technical changes eliminate whole classes of jobs and call for new skills. Retraining and successive careers will be commonplace.

— There will be irresistible pressure to enable people to continue in productive employment, long after age sixty-five, to enter new full-time or part-time employments and to take a full part in decision making at ages far higher than at present.

— As the amount of work available for humans is diminished by the microprocessor and the robot, the need for continued employment on *some* basis will expand as longevity is extended—a conflict of trends that will cause much dislocation in society.

— Employee benefit plans will have to be reconsidered from the ground up. New concepts as to retirement in a world of successive careers and extended longevity, of dependency in a context of working couples, of medical and death benefits during periods of reeducation, of shared jobs and continued part-time work, will all have to be woven into a new fabric of compensation and benefits to meet the needs of a population and a work force far different from that of today.

> It would be foolhardy to try to predict specific outcomes. We can be certain only that they will be unexpected and astonishing.
>
> –Maxine Singer, Chief, Laboratory of Biochemistry, National Cancer Institute

Demographic Surges

Wide publicity has been given to the post-World War II baby boom, which sent the annual number of births soaring from the 2.5 million depression level and the more normal 3 million post-depression level, all the way up to a 1957 annual peak of 4.3 million births. This was sustained at more than 4 million through 1965 but has since fallen back to 3 million—even as the swollen baby boom generation passes through its peak childbearing years.

The underlying total fertility rate per 1,000 women has fallen from 3,608 in 1960, to 2,885 in 1965, 2,432 in 1970 and only 1,770 in 1975. It now seems temporarily to have stabilized at about 1,800. This is far below the 2,100 needed for population replacement without growth. In an era of increasingly effective (and often irreversible) birth control, abortions and the elimination of unwanted pregnancies, deliberately childless two-earner couples, basic changes in the role of women and pressures against population growth, it does not seem likely that this fertility rate can rise very far from present levels.

Important questions of future labor supply, future age composition of the population, the future of the *pension burden ratio* (i.e., ratio of pensioners to workers) and the tax rates needed to support Social Security, are all interwoven with the future of the birthrate.

Charles Westoff, Director of the Office of Population Research at Princeton, points to the 200-year downtrend in birthrates, not only in the United States but throughout the developed world. Already, twenty-six of thirty-three developed countries have fertility rates below the zero-growth rate; seventeen are below 1,900 per 1,000 women and ten are lower than the United States.

Economist Richard Easterlin of the University of Pennsylvania thinks that, when the present large cohort is replaced by a smaller cohort (the survivors of today's fallen birthrates), the job market will be more favorable to them, and their sense of economic well-being will encourage them to establish families earlier. The birthrate will, therefore, tend to rise again in the late 1980s and 1990s.

But Dr. Robert Binstock of Brandeis University holds that 30 percent of today's women have resolved never to have children, and there is no way that the other 70 percent will decide to increase the number of their births to make up for this.

What *is* clear based on births that have *already* occurred, is that the number of workers who will be supporting each pensioner will be shrinking drastically in the coming decades, as the survivors of the huge post-World War II baby boom pass on into their retirement years, and the work force is populated by the survivors of the shrunken birthrates of recent years—that is, unless other basic changes are made. The United States, in common with much of the developed world, must look forward to an aging population.

The countries of the western world face inexorably rising medical, pension and social security costs (unless adjustments are made) and a growing demand for hospitals, special housing for the elderly and a long list of services to elderly people, including the burgeoning population of elderly widows.

We must think about sweeping technological changes, microprocessors and robots (which need no employee benefits), the lengthening of life, all in the context of birthrates well below the zero population growth rate in the western world and a rising tide of the aged in relation to younger people.

The design and funding of pension plans and social security systems reaches two generations into the future, yet we tend to set them up as though today's conditions will remain unchanged indefinitely. In the real world, there will be fundamental changes ahead. We must design plans that can be adapted to conditions as they unfold and avoid rigid commitments that are difficult or impossible to change, even in the face of a changed world.

Resource Depletion

According to the projections in the massive *Global 2000* report, which was completed over a three-year period by the joint efforts of many government agencies, mankind faces problems by the year 2000 of "alarming proportions." Environmental, resource and population pressures are intensifying to the point where the earth's carrying capacity is eroding. The trends point to a progressive degradation and impoverishment of the earth's resource base. To mention only a few points:

— While world population will have increased 59 percent between 1975 and 2000 (from 4 to 6.35 billion people), arable land will have increased by only 4 percent. Higher yields per acre depend heavily on the availability of oil and gas, which is not assured. Soils are deteriorating and desertification is accelerating.

— The world's forests are disappearing at the rate of 18–20 million hectares a year. By 2000, some 40 percent will be gone, and with them 20 percent of all species on earth.

— The quarter of the world's population in industrial countries will continue to use three-quarters of world mineral production, increasingly from less developed countries, inflaming demands for higher prices and a *new world economic order*.

— Atmospheric concentrations of CO_2 and ozone-depleting chemicals are increasing steadily as more coal and fossil fuels are burned and forests (which remove CO_2) destroyed. Acid rain, along with radioactive and other hazardous materials, are accumulating and spreading with consequent damage and threats to life.

Already some parts of the world have reached or exceeded their carrying capacity. Poverty, ill-health and deaths from hunger and disease will inevitably rise to massive and tragic proportions. The momentum of these trends will carry on far beyond the year 2000.

Although reforestation, soil conservation, birth control and similar programs are being pressed forward in some areas, far more is needed to counter the adverse trends which threaten all living standards over the long future.

Scarcity causes inflation. When we index a pension or Social Security benefit, we are in effect blandly assuming that none of these adversities can happen here or affect us in any way, and that we can somehow provide assurance that today's material standards can be maintained forever for all of those who do not work any more.

In opening its report, the 1979 Advisory Council on Social Security stated:

> The Council is unanimously convinced that all current and future Social Security beneficiaries can count on receiving all the benefits to which they are entitled.

As the number of pensioners swells, and the work force shrinks, will the robots be able to make good on these commitments?

The Sociological Upheaval

> I can live in peace and comfort until I die. Less than a century ago, it was the custom of my people to carry old, sick men from their huts into the bush, to be eaten by hyenas.
> —Pensioned law clerk in Nairobi, Kenya

If we place ourselves in the position of a group of employee benefit planners fifty years ago, could we have foreseen the establishment and vast expansion of the Social Security system, the crumbling of the family, the enormous rise in divorces, the rise of the single-parent family, social monogamy, trial marriages, the sweeping change in the role and outlook of women, their widespread migration out of the home and into the paid work force, the surge and later plunge in birthrates, the acceptance by society of more than a million abortions a year or the strong assertion of minority rights and now gay rights? All of this amounts to a sweeping social revolution.

The basic function of employee benefit plans is to protect employees and their dependents against the impact of catastrophe or medical emergency or loss of earnings due to disability or old age. When the concept of dependency itself is made obsolete, widowhood no longer means absence of income; when children are no longer the normal result of marriage and inflation robs pensions of their purchasing power, we have some fundamental rethinking to do. Consider, for example:

Marriage

— Since 1960, there has been a massive postponement of marriage in the U.S. as the proportion marrying at ages twenty to twenty-four has steadily declined.

— The early decline in the birthrate was due to the elimination of unwanted births; now it is the reduction in planned births as well.

— Predetermination in advance of the sex of offspring, with all its fateful consequences, is now on the horizon.

— Nearly one-half of the entire increase in new households between 1970 and 1976 consisted of individuals living alone or sharing housing with unrelated persons. This is now an accepted way of life which has also established itself widely in European countries. Unmarried couples living together in the U.S. tripled between 1970 and 1980 and now number about 1.6 million, or 2 percent of all households.

— One in every two to three marriages is now breaking up; one-third of all U.S. children live with a divorced or separated parent.

— A high proportion of divorced persons tend to remarry, but in recent years this has started to decline as cohabitation has begun to displace marriage.

— In trend-setting Sweden, one-third of all births are out of wedlock. In Denmark, the figure doubled in the 1965–74 decade to reach 18.8 percent—not much ahead of the present U.S. figure.

Role of Women

Between 1950 and 1978:

— Working women increased from 17.8 to 40.9 million.
— The proportion working increased from 34 percent to 49 percent.
— The proportion married, living with their husbands but going to work, rose from 23.8 percent to 47.6 percent.
— The ratio of working men to working women decreased from 2.5 to 1.4.

These trends have continued.

Women's groups in the U.S. have been advocating changes in the Social Security system based on the following concepts:

— Independent, not dependent status of women.
— Marriage as an equal partnership.
— Recognition of contribution of unpaid (homemaker) spouse.
— Equal benefits for one-earner and two-earner couples with equal earnings.

In this context, it is being said that the concept of female dependency is now meaningless. This may be true for the majority, but it is not true for all women.

All of the trends that seem to be separating marriage from reproduction, reducing the number of births and weakening the permanence of marriage, are tied in one way or another to the growing economic independence of women. The proportion of women in prime childbearing years (twenty to thirty-four) who are working outside the home (60 percent in 1976) is projected to reach two-thirds by 1990.

These deep-seated changes have called into being the institutional child-care facility, and now some employers can see in this a form of employee benefit that can meet a real need of single working parents.

These changes point also to a gradual fade-out of benefits based on the concept of dependency—such as the spouse's benefit under Social Security and various forms of widow's and survivor's benefits, and also to a need to eliminate the duplicate medical coverage that arises from the two comprehensive benefit programs of each spouse's unrelated employer.

As the spending patterns of two-earner families have reshaped the marketplace, with growing emphasis on big ticket items, eating out, leisure items, travel and child-care centers, so they should be expressing themselves in the employee benefit field with less need for life insurance and more emphasis on savings and investment facilities, flexible benefit choices, expanded IRAs and similar forms emphasizing the uniqueness and independence of the individual.

There are changes, too, in the attitude towards death, with some tendency to replace *heroic* life-support systems by hospice care for the terminally ill—now an emerging new employee benefit.

Displacement of Consumerism by Economics

For forty years, the Keynesian doctrine of consumerism and full employment in overcoming depressions by stimulating demand, has dominated the economic policies of many nations. As the pendulum has carried us further and further into the area of welfarism, the rising tide of entitlements has begun to place mammoth and politically sensitive burdens on the federal budget, while the indexing of benefits by means of a flawed and unsuitable index has compounded the problem.

Meanwhile, the share of the gross national product going to reward those who have provided capital and taken risks has shrunk, and with it the rate of savings and productivity and the real purchasing power of wages has topped out and begun to decline. Inflation has become deeply rooted and has exceeded the annual increase in wages.

To reverse this adverse tide, a whole new school of economic thought has now grown up, based on the concept that inflation can only be overcome if the supply of goods and services can be stepped up in relation to the demand. This can be approached both by curbing demand and by stimulating supply through increased productivity. This derives from a higher rate of savings and investment, plant modernization, stepped-up research and development and a shrinkage in government and in government deficits.

From this basic approach, we can see looming up, the outlines of a basic shift in employee benefit policies:

— an increase in types of plans designed to substitute the accumulation of savings, in place of current cash incomes or benefits now expressed in cash or its equivalent;

— an emphasis on funding of future benefits, rather than on nonfunded transfer payment systems, such as Social Security, which distribute contributions as received;

— an emphasis on keeping people working and producing rather than idle and consuming;

— a gradual elimination of the luxury of duplicating pension incomes from early retirement from one occupation while working full-time below age 65 in another (such as many police, fire and similar plans provide);

— a swing away from early retirement under Social Security and private pension plans, as increasing longevity, inflation and the need to slow down the rise in pension and similar costs asserts itself.

The full implications of this new economic approach reach far outside the employee benefit field. We have been in the position of letting inflation carry up our commitments to the support of nonproducers, while crunching down on the capability of industry to produce the goods needed to keep prices from rising. It is time for productivity to have a chance to recover.

Inflation, Interest Rates and Capital Formation

Deeply rooted in the economics of a world facing rapid population growth, in the context of deforestation and resource depletion, an eventual costly transformation of energy sources, an array of international controls based not only on oil but on other commodities also; and embedded in cost-of-living allowance (COLA) clauses, hyper-indexed benefits and labor's expectations at the bargaining table; inflation is a problem so large that the U.S. will find it difficult to hold even within limits that are high when compared with past experience.

In 1960–64, inflation rose 1.3 percent annually, on average; in 1965–69, inflation rose 3.4 percent annually on average; in 1970–74, inflation rose 6.1 percent annually on average; in 1975–79, inflation rose 8.1 percent annually on average; in 1980, inflation rose 13.5 percent annually on average.

At the enormous price of interest rates so high as to make the rest of the world wince, inflation has now shown signs of easing. This is encouraging, but it does not justify the optimistic view that we will return at any time soon to the kinds of rates that prevailed in the early 1960s.

This points to a need for:

— a better recognition of inflation in the design of employee benefits, without losing control of costs;

— an investment policy for pension funds that recognizes the probable long-term continuation of inflation, or even the contingency of hyper-inflation (such as through diversification into real estate among other forms of investment).

It has often been said that interest rates reflect the sum of: (1) anticipated inflation; plus (2) a basic return for risk and the use of capital. This is only partly true; there are exceptions, such as at present, when interest rates are being used deliberately to curb the expansion of credit and cool the inflation, or when inflation shoots up unexpectedly. But, in general, this relationship tends to hold up over the long term.

If, then, inflation is to stay at levels higher than we are accustomed to, interest rates will also continue to be higher than in the past. So what interest rates should actuaries use in calculating pension costs?

To raise the rate all the way up to current experience levels would assume their permanence and would ignore something else—the need to keep raising benefits to maintain benefit purchasing power.

Recent thinking in Canada is crystallizing around an entirely different approach. This would consist of:

— restricting the actuarial valuation interest rate to the basic rate (such as 3.5 percent) which ignores inflation;

— mandating by regulation that any interest earned above this rate be applied to increase benefits, both for pensioners and also for workers and vested, terminated employees—it is assumed that this *excess interest* reflects the inflation and *belongs* to these plan members.

This approach may sound novel, but it has certain merits. It would enable pension costs to be fixed where they could be seen and funded, and it would remove the uncertainties of ad hoc pension adjustments at the whim of the *Board*. Pension costs and funding levels would be higher but not if these ad hoc adjustments are granted and included in the cost comparison.

There are, of course, many other ways of adjusting pensions for inflation. Full indexing of the CPI merely overexpands benefits as a result of the defects in that index and involves an open-ended commitment. Partial indexing with a lag may be more acceptable. The use of the lower of the CPI and a wage index has been proposed for the bloated Social Security system, though stronger medicine to recognize the shrinkage of consumption as age advances is quite justifiable.

The present high interest rates have certain other merits in our current situation. They encourage savings and investment, not by using borrowed money, but by refraining from consumption and accumulating capital that way. The needs of the U.S. and the world for real new capital were never greater. With vast energy resource capital needs, the conversion of industry to robots and automation, the sweeping out of office and communication equipment before the onslaught of the microprocessor, the financing of research and development in the pharmaceutical and biomedical fields, the equipping of the Third World with agricultural and industrial capital—all these, along with the possible needs of a strong entry into the space age of the future, will call for unimaginable amounts of capital. Funded pension plans will furnish a goodly portion of this capital. So will thrift and savings and profit sharing plans.

Impending Rejection of the *Social Contract*

Woven through many reports and high-level statements about the Social Security system, are references to a mythical *social contract* that is supposed to bind each generation of workers to pay taxes and entitle each generation of retired workers to the benefits provided by the system.

Mostly this theory seems to be invoked as a defense against any suggested curtailment of benefits. And yet, after more than forty years of operation, no one retiring under the system, even after paying the maximum taxes all the way, has come close to paying for the actuarial value of the benefits received. Those at lower pay levels have been even more heavily subsidized by their successors.

What is more important, no one has ever explained to today's children what it is they are being saddled with in accordance with this awesome social contract to which they are supposed to be parties. We teach them at length about history and geography and arithmetic and language and science and social studies, but nothing at all about this social contract to which (without their knowledge) they are bound. Remember that today's children are few, and their parents' generation is large; so the burden they will be assuming under this contract will be very onerous to them. But just how onerous?

Very few people understand the long-term outlook for the Social Security system. Partly this is because it is crowded out by the short-term financing problems of the system. Partly it is because the long-term outlook has to be sorted out from four different sets of projections of costs on bases ranging from unrealistic optimism to pessimism; and partly it is because one part of the system is covered by seventy-five-year projections, while another part (the HI part) is covered only by twenty-five-year projections. Neither the public nor Congress has any way of putting the parts together over the longer period, and an entirely misleading impression has thus arisen as to the real long-term financial outlook of the system.

> There is no valid justification for limiting the (HI) projection period; it should be the same seventy-five-year period that is used in determining the actuarial balance of the OASDI program.
>
> —Haeworth Robertson, past Chief Actuary
> Social Security Administration

The fact is that a seventy-five-year HI projection *does* exist, but it is not published or combined with the OASDI figures (which are published). It seems to require a person from outside the government to combine it with the OASDI projection and, thus, to get at the real facts about the system. This we have done.

Working with Dr. Rita Ricardo-Campbell of Stanford University, a well-known and experienced economist, author of books and papers on Social Security and past member of the Social Security Advisory Council, we arrived at a single down-to-earth demographic and economic projection basis (fully described elsewhere), which the actuarial staff of the Social Security Administration courteously converted into a seventy-five-year projection. This is what it showed:

— a far more serious long-term financial outlook than is generally known;

— a seventy-five-year average combined deficiency of 9 percent of payroll—not the 1 to 2 percent of payroll currently published in OASDI reports;

— tax rates, in the second twenty-five years of the projection period, unable to pay for even two-thirds of the benefit costs;

— a system really falling apart in the third twenty-five years, with tax rates *not even one-half* of projected benefit outflows and benefits soaring to almost one-third of the nation's payroll.

If this system is to survive and be placed in a viable condition, as it must be, it is inescapable that any idea of a social contract based on today's benefits and taxes will have to be junked. No one can claim that today's children are obligated to meet the costs that will arise under it in their lifetimes, nor are they in any way likely to accept the idea. Major changes in the system will have to be made.

Among the prime candidates for the changes that will obviously have to be made are, for example:

— deferment of the benefit commencement age to keep in step with the projected extension in longevity;

— overhaul of the basic benefit formula;

— substitution of a more suitable approach than the present indexing of benefits;

— elimination of the spouse benefit;

— greater emphasis on rehabilitation of disability cases and lower ceiling on disability benefits;

— overall limitation on size of benefits governed by size of active payroll of the nation.

The sooner the public is made aware of the basic facts about the long-term outlook of this system, the sooner we can begin the inescapable job of redesign. Here we are not talking about millions or even billions of dollars. The nation's payroll is now about $1.1 *trillion*. With a growth rate of even 6 percent, it will reach $87 trillion by the end of the seventy-five-year projection period. We are talking about a program which has committed the nation to provide benefits costing from *one-sixth* (first twenty-five-year average) to almost *one-third* (last twenty-five-year average) of these enormous amounts, and a program whose system of support is likely to *fail* by a margin growing to *more than one-half* in order to provide the promised benefits.

This translates into a *deficit* rising from its present worrying size to *well over $10 trillion annually*. (That would make seventy stacks of dollars from the earth to the moon.) How's that for a social contract?

Some Far-Out Trends and Possibilities

Everything presented in this paper so far might be regarded as down-to-earth realism. But I would be failing in my duty as a futurist if I did not make some reference to two basic thoughts that may sound like science fiction. At least they may challenge your imaginations.

Scenario 1

— Multinational corporations continue to strengthen their grip on world economies.

— National economies become more and more interlocked and interdependent as resource scarcities increase.

— Nuclear proliferation continues.

— The present balance of terror, based on the doctrine of mutual assured destruction and the ICBM, gives way to technological advances in direct-energy-transfer weapons (charged-particle beams and space-based high-energy lasers), rail guns and killer satellites.

— In the end, one of the two superpowers gains a clear advantage; or, world outcry against the diversion of economic resources (presently \$1.5 billion *per day*) into armaments, instead of the relief of hunger and economic needs, continues to rise in an ever-louder chorus.

— In the upshot, the concept of sovereignty—the splitting up of the world into separate nations—gives way to a more unified world with a central government.

— One of its first acts is to set up a world currency and a *global* social security system.

Something along these lines was foreshadowed (but without my buildup to it) at a meeting of the World Future Society in Washington, D.C. in 1980. I leave it to you to ponder its possibilities and implications.

Scenario 2

— Population pressures continue to build up in the world as resources are depleted, land eroded, forests stripped away and CO_2 and air pollution increase in quantity.

— Radioactive and toxic chemical wastes continue to accumulate and threaten life everywhere.

— Nuclear weapons proliferate into dangerous and unstable hands.

— Meantime, technology continues to advance on the *high frontier*—solar power satellites are proved feasible—the volume of industrial activity in the clean, pure, weightless conditions of outer space increases—enthusiasts for the escape of space colonization gain increasing support—the idea finally takes hold and a stream of migrants transfer to fully developed space colonies.

It is your assignment to develop benefit programs to operate in either of these sets of conditions.

Conclusion

If there is one basic conclusion that emerges from all of this, it is that benefit plans should never be frozen in rigid, cast iron terms that cannot be adjusted frequently, and even radically if need be, to cope with change. Whether it is due to technological work upheavals, rapid lengthening of life, abrupt changes in birthrates, world impoverishment, unprecedented inflation, reversals in social attitude or economic policy, breakdowns in the Social Security system, or other more far-out causes, there will continue to be change. Only those who can successfully adapt to this change will survive.

Employee Benefits: Adjusting to Past Change

Anna M. Rappaport

The Calvert paper points out the potential for major change in our society affecting all of our institutions and the relationships of individuals to institutions. Of greatest importance to us today is the change that has already occurred, particularly in life cycle and family patterns. It is vital that we focus on the life cycle and family patterns of today and that we examine our compensation and benefit practices to see how they fit. It is my contention that the problem facing us is not adjusting to future change, but rather bringing systems to the level where they reflect the family patterns of today. At that stage, it will then make sense to look further into the future.

A New Planning Environment

Tables 1 and 2 contrast the traditional post-World War II expectations with the reality of the 1980s. Our problem is that security systems in existence today are largely built around traditional expectations, which I have called the *American Dream*. The needs of today's population are far more complex; and over the next decade, we must respond to some of the following issues that have already surfaced:

(1) Nearly one-half of the American labor force are members of a family with two spouses working. They need security that works for them as a family, and for each individual considered separately. Security systems in existence today generally do not address this issue.

(2) The Calvert paper pointed out the growth in the number of unmarried couples. For most purposes, many of these couples are similar to married couples. If we are to meet the needs of all employees, this trend requires even greater flexibility in benefit programs to accommodate couples not now recognized as such.

(3) Lifelong education and maintaining skills on an up-to-date basis may well become the most significant security issue of the decade to come. The rate of technological change is such that many jobs will become obsolete and others will change. This need for education will become increasingly a major security need. It will grow to rank in importance with the need for retirement and disability benefits.

TABLE 1
Life Styles and Family Patterns

Traditional Post-World War II Expectations = American Dream	Reality of 1980s = Diversity of Lifestyle/Individual Choice
Linear life cycle.	Cyclical life cycle.
Education—usually completed by age twenty-five; viewed as a pre-work period activity.	Education—lifelong.
Family—traditional breadwinner husband, homemaker wife, two to three children, long-term stability.	Family—diverse mix of traditional two-income family, single with dependents, shifting over life.
Family stability—lifelong marriage expected.	Family stability—divorce rates high, and shifts accepted.
Children—two to three norm per family.	Children—very low birthrates.
Continually rising income in real dollars.	Flat income in real dollars, decreasing on an after-tax basis for many.
Homeownership expectation of most Americans.	Homeownership difficult for many; shift to multifamily housing.
Cheap unlimited energy.	Expensive energy.
Retirement at ages sixty to sixty-five.	Retirement future unclear.
Good employer equals job security.	Much less job security as all employers become cost conscious, more mergers, business failures, etc.
Good work ethic; upward mobility based on merit.	Less work ethic; search for self-fulfillment.
Rising productivity.	Flat productivity.
Trust in institutions.	Lack of trust in institutions.
Sex-based job distinctions on a de facto basis.	Eroding of sex-based job distinctions; emergence of employee rights.
Employer control of work place.	Search for new employer/worker partnership.
High-technology medical care viewed as solution to health problems.	Search for solution to health problems.

TABLE 2
Employee Security Problems

Traditional

Job security.

Unexpected high medical care expenses.

Income replacement due to:

- death of income providers;
- disability;
- retirement;
- unemployment.

New

Child care.

Education to maintain employability.

Find means to achieve homeownership.

Self-fulfillment.

Maintain already achieved living standards.

(4) Job security is emerging today as an increasing concern. Employees and unions can be expected to focus more on job security, and we may see moves to build security into employment relationships.

(5) Homeownership, once a part of the American Dream for nearly all families, is becoming more and more difficult for the family of the 1980s. Employers are not directly involved in helping employees attain homeownership, but this issue can be expected to surface in the decade ahead.

(6) One of the major problems for many families with children is finding adequate child care at an affordable price. A few employers are involved with the provision of child care at this time. Over the decade ahead, more employers will be involved with child care, and such involvement will be a way of helping the two-earner family address its needs.

(7) Education of children is becoming a burden which is very difficult for many families. College costs have risen to very high levels while at the same time, government assistance is decreasing. Many of today's employees expect to send their children to college and may be seeking employer assistance to help them accumulate capital for this expenditure.

(8) Eighty percent of the population is in some way involved in the search for self-fulfillment, and many want a job that is interesting and meaningful. At the same time, employees are faced with flat, after-tax, inflation-adjusted family income and employers are faced with a slow rate of productivity growth. A new partnership is needed if satisfactory results are to be realized.

(9) Individuals want choices and many are making choices about life patterns. Increasingly, we will see what can be described as cyclical life patterns. Such life patterns, at present, are in conflict with the model underlying our security systems.

Responding to Changing Demands

How can employers respond to the challenges presented by accomplished social change? What must they do?

For each employer, the solution to the challenges will depend on business needs and circumstances. It is my contention that a systematic approach to compensation and benefit planning must begin with a complete analysis of the situation and objective setting. These hold the key to the best solution. That solution must be tailor-made to the situation and must consider the internal and external environment. Some of the likely changes over the next decade include:

(1) Finding tools to sort out complex issues and priorities through a rational planning process.

(2) Responding to diversity of the family by: expanding individual choices through the provision of more contributory plans and/or benefit trade-offs; allowing a trade-off for dependent medical care; and increasing employer day care involvement.

(3) Recognition of job security as an employee concern.

(4) Building an employer/employee partnership to meet common goals.

(5) Providing for meaningful lifelong education by encouraging and financing such education.

(6) Assisting employees with homeownership.

(7) Assisting employees to get through the problems of divorce.

(8) Offering a greater variety of work and retirement options.

(9) Gradually reversing the present trend toward early retirement; making gradual retirement possible through new work options.

Problems

Employers will face many problems that will have to be addressed creatively. There will be a need for integrated strategic human resource planning, a greater emphasis on employee communications and an appreciation of greater administrative complexity. Also, benefits integration will become more and more important as a means of meeting demands while avoiding the problems of adverse selection.

Employee Benefits: More Than You Want and Less Than You Need

John A. Haslinger

Introduction

An assessment of the effects of changing family relationships on employee benefit plans is especially appropriate, since changes in the family that were brought about by industrialization and urbanization were the major factors in creating a need for employee benefit plans in the first place.

Historically, one of the most significant functions of the family has been to provide for the security needs of its members. The extended family, stretching over three or four generations, was an ideal format for fulfilling this function. Family members were assured of food, clothing and shelter if they became ill or disabled, or when they became too old to engage in productive labor. Moreover, the family could, and usually did, continue to provide these basic necessities even if one or more of the productive members died. In effect, the extended family provided a form of health insurance, life insurance, disability insurance and pension coverage to all of its members.

The extended family was ideally suited to an agrarian society, in which every member of the family contributed something to the economic prosperity of the entire group. Whether it was the adults harvesting the crops, the older children helping around the farm, or the grandparents caring for the younger children, almost every member of the extended family represented an economic asset.

The United States has not, however, remained an agrarian society. Less than one hundred years after the American Revolution, the United States was rapidly becoming industrialized. By the 1930s, we had become a nation of technology and industry. We had gone from a country in which 95 percent of the population was raising crops, to one in which fewer than 20 percent were farming, and that figure kept dropping. Grandparents and children, who had once been an economic asset due to their contributions to the family, were suddenly an economic deficit.

Instead of helping to support the family, they drained the small income which the father, and occasionally the mother, was able to earn in the factories. Children contributed little until old enough to work and this age was constantly being pushed upward. By the time most children could bring in an adequate income, they left home to start families of their own. Grandparents could contribute nothing economically and as life expectancy rose, so did the number of nursing homes. In America, the traditional extended family was dead.

Obviously, other factors contributed to this. The high degree of mobility brought about by the development of rail travel and later cars and planes, the need to travel to obtain certain job advantages and the cross marriages between various cultures, all contributed to the demise of the extended family. However, all of these factors can be traced to the rapid growth of industry in this country.

Although the extended family was rapidly disappearing, the security needs it had once taken care of were not. Workers and their families still needed protection in the event of disability, old age and death, and it was these needs which laid the foundation for the emergence and growth of employee benefit plans.

The Growth of Employee Benefits

While the need for employee benefits may have existed, their growth was slow for a variety of reasons; the most important were:

- Cheap labor was available due to massive immigration between 1840 and 1910, this minimized pressure to provide such benefits.
- The strength of the protestant work ethic and the emphasis placed on the value of individualism.
- If the wage system or factory life became intolerable, workers had the alternative of going west and staking claim to the cheap or even free land.

Thus, it was not until after the Great Depression that employee benefits began to become widespread. The Depression, by wiping out personal savings and throwing almost 13 million people out of work, vividly demonstrated the need for government and industry to provide protection against at least some of the risks associated with loss of earnings.

Most significantly, the Depression created a climate favorable to organized labor, resulting in the passage of the Norris-La Guardia Act in 1932 and the Wagner Act in 1935. These acts guaranteed employees the right to join unions of their own choosing, free of employer coercion, and required the employers to bargain with such unions in good faith.

By the end of World War II, labor unions were firmly established and by 1949, they had won the right to bargain for pension and insurance benefits. While unions spearheaded the initial flight for the development of employee benefits, both unorganized labor and management recognized the need for security benefits, which had been clearly demonstrated by the Great Depression.

Most employers were, and remain, legitimately concerned for the welfare of their employees. This concern grew primarily out of the practical realization that providing benefits for employees could result in increased productivity and improved worker morale. It also reflected an expanding social consciousness on the part of many employers.

Because of these considerations, the benefit plans which emerged during the 1950s and 1960s were primarily concerned with two items:

— income replacement in the event of retirement, disability or death;

— medical coverage to keep the worker, and later his family, healthy and productive.

Employee reaction to improved benefits was favorable, the government provided tax incentives to employers for providing benefits, and the postwar economy was booming. The predictable result was a rapid and continuous growth in the number and cost of employee benefits.

TABLE 1

Growth of Employee Benefit Payments

Year	Employee Benefit Payments as a Percent of Payroll	Employee Benefit Payments Per Payroll Hour	Employee Benefit Payments Per Year Per Employee
1979	41.2%	$3.22	$6,823
1977	39.9	2.64	5,388
1975	37.6	2.31	4,731
1973	35.1	1.78	3,677
1971	33.0	1.46	2,990
1969	31.0	1.19	2,460
1967	29.1	1.02	2,114
1965	27.1	.87	1,793
1963	26.8	.80	1,646
1961	25.8	.72	1,476
1959	24.4	.63	1,299

Source: U.S. Chamber of Commerce.

According to the U.S. Chamber of Commerce, for example, employee benefits represented approximately 24 percent of the average payroll in 1959. By 1969, this figure had risen to 31 percent and by 1979, employee benefits represented over 41 percent of the average payroll in the U.S. and cost almost $7,000 per employee per year.

The question facing us today is whether traditional approaches to employee benefits effectively meet the needs of our employees.

Our answer at American Can is that they don't.

Changing Circumstances

Table 2 illustrates the life cycle of a typical employee. Of course, not every employee goes through each stage at the same point in his or her life. In fact, some employees may skip certain phases entirely—parenthood for example. However, this table is useful in illustrating how an employee's needs change over the course of time.

For example, an employee who is twenty-six, male, unmarried and attending graduate school has different benefit needs than an employee who is thirty-five, male, married, has three children and a large mortgage to pay. And both of these employees have different needs than a thirty-year-old woman who is supporting two children on her own. The point is, each of these employees need different things from a benefit program.

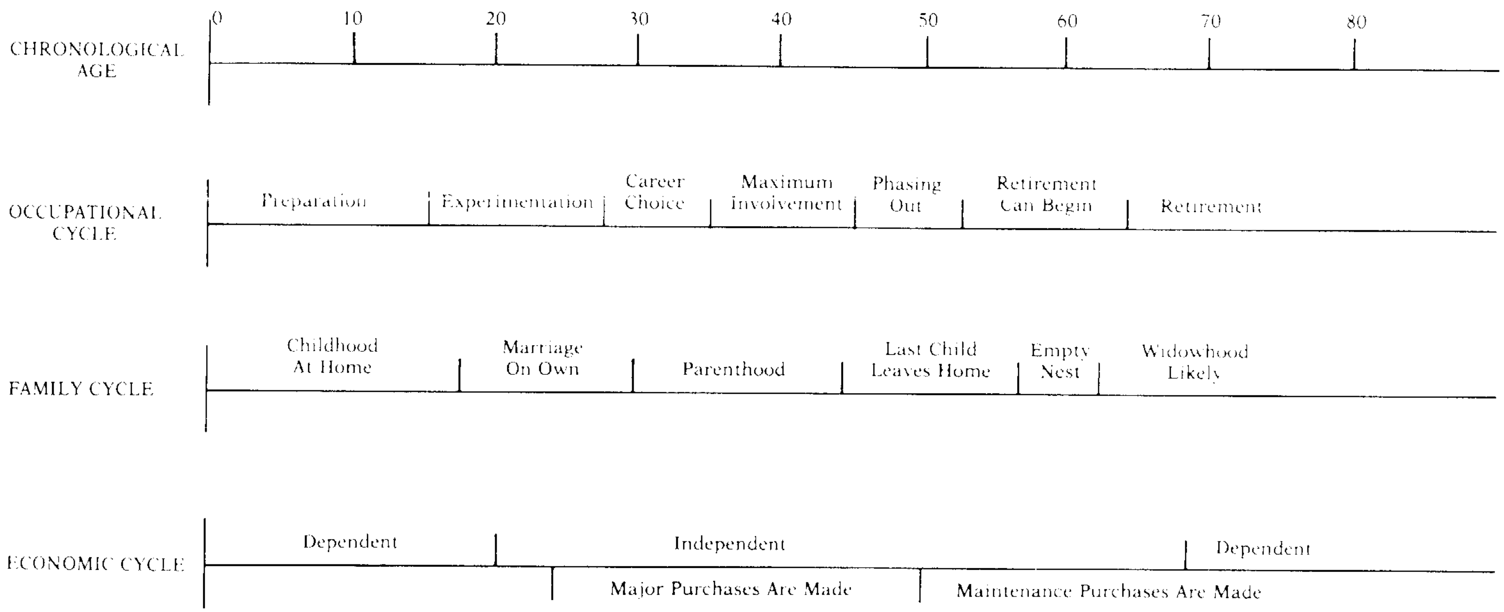
The first employee may want extra vacation time, while not being especially concerned about life insurance or health coverage. The second employee may want significant life insurance protection along with a high level of medical coverage but may be willing to forego additional vacation time. The third employee may need broad medical coverage, assistance with day care expenses and extra vacation time, while not being interested in supplementing the basic pension program.

Why force employees to accept coverage they neither need or want, when at little or no additional cost, each employee can be allowed to choose the coverage he or she does want? American Can's answer is to give each employee a free choice.

Most companies, however, do force all employees into a single benefit plan, regardless of individual needs. These plans, which originally emerged after World War II and have been greatly expanded since that time, are based on several erroneous assumptions regarding the

TABLE 2

Life Cycle for a Typical Employee



typical American worker and his family. Briefly, these assumptions are:

— there is a typical American worker who has the same security and benefit needs as all other workers;

— this worker is male and he is the sole or at least primary source of income for his family, which consists of a homemaking wife and two or more children;

— the worker will spend most of his productive life with a single employer;

— the economy will remain relatively stable—that is, there will not be significant periods of inflation or recession.

If these assumptions were ever valid, they are not today. The simple truth of the matter is that almost no one fits this typical profile. According to a recent U.S. Department of Labor survey, fewer than 10 percent of American families are comprised of a father who is the sole source of income, a homemaking mother and two or three children.

In fact, based on the 1980 Census, children with working mothers have become the rule rather than the exception. Women have entered the labor force in ever increasing rates. In 1930, for example, only about 20 percent of all workers were women. By 1960, over 30 percent of the labor force was female and in 1980, more than half of all women were working and comprised over 40 percent of the total labor force.

TABLE 3

Women in the Labor Force

Year	Actual Number	As a Percent of All Workers	As a Percent of All Women
	(thousands)		
1990 (est.)	54,253	46%	56%
1980	44,126	43	51
1970	31,560	37	43
1960	23,272	32	38
1950	18,412	29	34
1940	13,007	25	26
1930	10,396	22	24
1920	8,229	20	23
1910	8,076	21	23
1900	4,999	18	20

Source: 1980 Census.

The majority of these women are part of dual-income households. Frequently, such families have decided to postpone or forego having children. In addition, since dual income families earn 20 to 30 percent more than traditional earner families, leisure time is often more important than more traditional forms of compensation and benefits. Moreover, the security provided by two incomes permits either spouse a greater opportunity to change jobs rather than remain with a single employer over the course of his or her career.

A smaller group of women, but a group that is growing at a phenomenal rate, maintain a household and family as a single parent while also working. In 1979, over 17 percent of all American households were one-parent families maintained by a mother. This represents an 81-percent increase from the 1970 level of only 10 percent.

Not only have women entered the labor force in increasing numbers, but so have minorities. In addition, the baby boom population has reached maturity and has begun working, while many older workers have decided to continue working.

The needs of these new workers are as disparate as the people themselves. About the only thing they share is an increased consciousness of choice and personal fulfillment. Simply put, the new worker expects greater control over his work and work-related factors than did his predecessors.

Finally, the economy has not remained stable. Inflation has resulted in massive increases in the levels of wages and prices during the past twenty years. Benefit plans designed in the fifties and early sixties are today, for the most part, tied directly to the level of wages and/or prices (i.e., pension plans with formulas based on final average earnings—many with COLA provisions—medical and dental plans which pay reasonable and customary bills, disability and life insurance plans which calculate benefits on the basis of an employee's salary at the time of a claim, etc.). The 1960s and 1970s saw the proliferation of these employee benefit plans.

Existing health, life and disability plans were expanded and improved while virtually every major industrial company as well as many small ones implemented dental plans. During this period, medical plans were created which had small deductibles and high levels of coinsurance for most expenses, along with *first dollar coverage* (expenses not subject to a deductible) with respect to hospital-related expenses. In addition, many companies added various types of profit sharing or savings plans as supplements to company retirement plans.

A predictable result of this flurry of improvements was a massive increase in the cost of employee benefits. National health care expenditures, for example, have skyrocketed from $12.7 billion in 1950, representing 4.5 percent of the gross national product (GNP) that year, to almost $250 billion in 1980, representing 10 percent of that year's GNP, and show little sign of slowing. It is estimated that private benefit plans directly pay between 40 and 50 percent of this bill today.

Other benefit costs, especially pension funding expenses, have risen at equally alarming rates. For example, annual contributions to private pension plans (i.e., those plans sponsored by business and/or unions) rose from approximately $2 billion in 1950 to over $32 billion in 1975.

Inflation, combined with dropping productivity and the aging population, which uses these benefits more frequently and for longer periods while contributing little or nothing towards them, has pushed Social Security to the point of bankruptcy and created a crisis in the funding of private benefit plans.

New Approaches

Despite the large sums of money which companies were spending on benefits, corporations were finding that benefits were items that were taken for granted by employees and certainly not of any interest to them until, of course, a particular benefit need or emergency arose.

The feeling on the part of most corporations was that a lack of comprehensive benefits was detrimental to attracting high quality employees and bad for employee morale, but that having good benefits would add little towards attaining corporate objectives, much less, assist in enhancing employee morale.

It was in the early 1970s that we began to see signs of what we believe to be the future look of employee benefit plans.

The idea was to involve the employees—getting them to participate in those issues and benefit programs affecting them and, thereby, enhancing the value of those items. The desired objectives were simple:

— to increase the number of satisfied employees and, thus, improve worker retention and productivity;

— to improve the cost management of the benefit programs.

The solution seemed obvious—give the employees a choice. Why not permit employees to choose their own benefit programs—after all, we don't tell them how or where to spend their paychecks.

In the early 1970s, several corporations began to involve employees in just such decision making. For example, Cummins Engine established study groups of employees and found their employees receptive to getting involved in issues that affected them. Xerox Corporation also set up an elaborate system of employee study groups and found some support for employee involvement.

These types of exercises led to the conclusion by many, that by letting employees have control over the benefits they receive, employee benefits could become a positive part of total compensation rather than having a neutral or even negative impact. A *flexible benefits program,* which gave employees some degree of latitude on benefit selections while permitting management an increased degree of control over rising costs, appeared to be highly desirable for all concerned.

The first flexible benefits program was actually established in the early 1970s by TRW. The company took their then existing coverages in medical and life insurance and permitted employees to choose either a higher or lower level of coverage. If the employee chose benefits of greater value, payroll deductions were required; but if less coverage was selected, the employee would be paid the difference in cash. Up to the present day, employee response has been positive. Employees who selected, and presumably only needed, the lower level of medical or life coverage could now receive cash out of the program.

Around the same time, the Educational Testing Service (ETS) also introduced a flexible benefits program. In an effort to enrich their program, ETS added options to their existing benefit coverage, permitting each participant to select those that were most appropriate or appealing. Employees were asked to help design benefit options, which contributed to the positive response by employees. This, along with the fact that benefits were clearly being improved, meant an enthusiastic acceptance by participants.

Although off to a promising start, flexible benefits programs failed to spread rapidly during the 1970s. Several misconceptions hindered their development.

First, there was a general belief that these types of programs were for special situations or work forces, and not really suited for major industrial concerns or companies with widely dispersed employee populations.

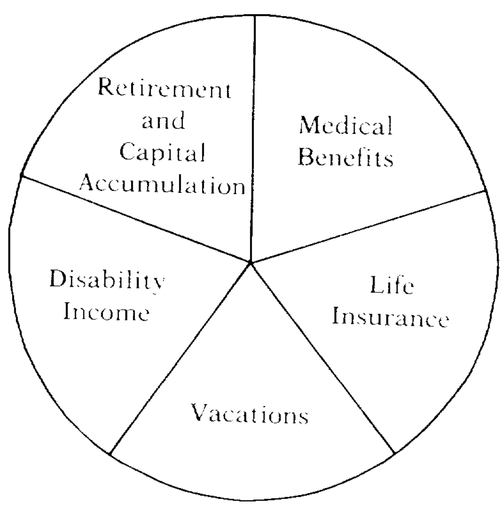
In addition, many firms lacked progressive benefit leadership and were slow to make the shift from outdated, and often poorly staffed, personnel departments to the broader human resource function. There was a certain amount of reluctance, especially among the solidly entrenched *old guard*, to tackle the complexities of a flexible approach that presented tough legal problems, enormous communication efforts and complex design questions.

Finally, the 1974 Employee Retirement Income Security Act (ERISA) stifled and discouraged further development of flexible benefits programs. ERISA prohibited such programs from allowing employees to trade among taxable (cash) and nontaxable (tax-qualified benefits) options without being in constructive receipt of such value. Thus, such benefits were includable as part of taxable income. This legislation did contain *grandfather provisions* that protected the programs of TRW and ETS, but it offered no incentive to new programs. In the face of these obstacles, the general consensus seemed to be that the concept of flexible benefits was doomed to failure.

Nevertheless, in 1978, American Can introduced, on a pilot basis for 600 salaried employees, a new generation of flexible benefits. The program offered a wide variety of options in the five major benefit areas—medical, life, vacation, disability and capital accumulation/retirement. This was the first program of its kind to be so comprehensive as well as the first which made use of a system of *flexible credits*.

American Can's program design involved reducing the existing benefits in each of the five substantive areas to a *core* or minimum level of coverage. The difference in value between the existing coverages and this core was given back to the employee in the form of flexible

FIGURE 1



credits that could then be used by the employees to purchase optional coverages, which they wanted or felt they needed.

Along with the results of the one-year pilot program, extensive sampling and the use of employee study groups went into the plan design of the final corporate-wide program. The result was that in 1979, the program was extended to all 8,000 salaried employees across the U.S. The potential for adverse employee reaction due to the *take away* perception of the program was neutralized by guaranteeing that employees, if they wanted to, could *buy back* their preflexible benefits coverage, with the flexible credits generated under the program.

For the flexible benefits program to be a success, ongoing employee involvement and communications were essential. These goals were achieved through a variety of approaches including employee meetings, surveys, a *listening post* program and a flexible benefits *hot line*. The last two services enabled employees to have specific benefit questions answered. In addition, a monthly flexible benefits newsletter was introduced to provide benefits information of general interest to all employees.

In order to further enable our employees to make the most informed choice possible, we also provided each employee with a personalized benefits statement which summarizes each person's coverage, the present and future value of that coverage and the amounts actually received during the year under each benefit.

The most important aspect of employee involvement, however, is the annual enrollment process. Each fall, all employees are provided with an enrollment form on which they indicate the various benefits they want for the coming year. The result is a unique benefit package for each employee, which has been personally tailored to every person's specific needs.

American Can's program was significant in several respects. It marked the first such program for a major industrial company with a significant number of participants, as well as involved all five of the key benefit components (i.e., medical, life, vacation, disability and capital accumulation/retirement). Despite unfavorable legislation, American Can designed a meaningful program with choices that provided increased value to participants.

We have accomplished what we set out to do—namely, to design a program that would:

(1) provide employees with added value through flexibility;

(2) establish ACC as a progressive, innovative company, thus, increasing its ability to attract and retain high quality employees;

(3) give the corporation a measure of control over escalating benefit costs.

Flexible Benefits and Employee Reaction

Perhaps the most significant of these achievements is the increased value a flexible benefits program can offer all employees. While most companies provide identical benefits for their employees regardless of employee needs, a flexible benefits program allows employees to choose the benefits they need, at different stages in their life, at little or no added cost to the company.

This approach has received enthusiastic acceptance from our employees. In a randomly selected telephone survey conducted among our salaried work force, an overwhelming majority (95 percent) felt that the flexible benefits program enabled them to choose coverage better suited to their own personal needs than did the *preflex* plan. Seventy percent of our respondents felt that the flex program was a major improvement over the previous benefit plan, while 60 percent felt that the value of their benefits had increased.

Comments such as "now I don't have to take coverage I don't want," "I like being able to invest in the capital accumulation plan," and "being able to buy extra vacation is fantastic," were the most frequent reasons given for liking flexible benefits.

In order to determine what type of employee is choosing specific benefits, we track benefit selection by such variables as sex, salary, age and whether or not the employee has dependents. Each month, we generate an updated summary of enrollment broken down by these characteristics. This is used for planning purposes. Let me give you some illustrations of how different employees have selected different benefits.

In the area of medical coverage, we have found that over 85 percent of the employees choosing the *core* plan are part of two-income families, in which their spouses have health coverage provided through another employer. Thus, these employees choose a medical plan with high deductibles and only an 80 percent copayment level in order to *free* credits for other benefits such as extra vacation or our tax-deferred savings plan.

On the other hand, our *A-3* medical option which costs $525 in either flex credits or payroll deductions, but which requires a far lower annual deductible and pays 100 percent of reasonable and customary, is most popular among employees who are between the ages of thirty-five and fifty and who have families.

Similar patterns have emerged in our other benefit areas. Employees with dependents, who are between ages thirty and forty-five, account for roughly 60 percent of those choosing to enroll in the long-term disability plan that pays 70 percent of base salary up to a maximum of $70,000. Alternatively, employees over age fifty make up a mere 9 percent of those selecting this particular option; although they comprise 32 percent of our total labor force. Some of these older employees have selected lower levels of disability coverage now that their children are older, in order to supplement their pensions through our capital accumulation plan.

In addition to an enthusiastic employee response, we have found that the flexible benefits approach can be a cost effective system for providing benefits, especially in the health care area. Given a choice, employees will voluntarily reduce their coverage and do more self-insuring to meet other personal needs.

By adding different features to each of the health plans we offer—including a wide variety of preventive health options—we have been successful in getting employees to shift out of inefficient and expensive health plans and into plans that reward efficient patterns of utilization and encourage individuals to stay healthy, including HMOs. In fact, we found that less than 10 percent of our employees chose the most comprehensive and expensive medical plan. Our success in this area is the direct result of our emphasis on employee involvement, along with a considerable and ongoing effort in the area of education and communications.

The Future

The decade of the 1980s, with respect to employee benefits, will be a time when companies will focus on the cost of benefits and will take steps to get these costs under control. Besides adopting provisions in their medical programs that are aimed at assuring quality health care, there will be an emphasis on preventive health and keeping employees out of hospitals, which currently can cost upwards of $500 per day. Companies will be educating employees on how to use their health coverages effectively, and they will be encouraging employees to share some of the risk. There is growing support for providing employees with financial incentives—both direct cash awards and indirect incentives—for not using some of the benefits provided. Surgical opinions, home health care, ambulatory surgery and pre- and post-admission testing are only a sample of the types of coverage that will be emphasized during the 1980s.

The more we can get employees to shift benefits from the health area—the area with the fastest level of cost increases—to other areas like vacation or putting money (flexible credits) into their savings plans, the slower our rate of increase will be in health care costs and overall benefit costs.

The eighties will also be a time when companies begin to respond to the different needs of a changing work force. We will see the emergence of new types of benefits in response to changing employee demographics and new employee needs. Coverage for such things as day care, financial planning, adoption, auto and home insurance and legal representation will be developed and gain acceptance. In fact, American Can has recently implemented several of these new benefits, and we are actively investigating others.

Further, problems of employees which were once felt to be personal will now begin to fall within the realm of corporate responsibility and become more closely tied to overall productivity. Employee assistance programs to deal with items such as alcoholism, emotional problems, marital discord and drug abuse will be implemented by more companies on a strictly confidential basis.

Conclusion

The future of flexible benefits can best be described as positive. The Miscellaneous Revenue Act of 1980 has paved the way for further growth of these types of plans. The Act permits flexible benefits plans to give employees a choice between taxable, nontaxable and deferred compensation benefits without giving rise to any constructive receipt problems. This development, and the increasing competitive pressures to be responsive to employee needs, point to a bright future for these types of plans.

In addition, as the inflationary spiral continues and as benefit costs keep rising, companies will increasingly be looking for ways to minimize increases by obtaining more control over costs and by maximizing the productivity of current programs. While flexible benefits programs should not be implemented based on cost considerations alone, there is no question that if carefully designed, they can offer a more cost effective way of providing employee benefits.

It seems likely that the changing needs of employees and their families, coupled with cost considerations, will ultimately result in the convergence of benefits, salary and work schedules into a flexible compensation package. Under such a program, employees will be able to choose, within limits, the hours and days they will work as well as how they will be compensated. Employees will be able to take part of their compensation in the form of wages and the rest in the form of benefits, which will be limited only by the desires of the employees themselves.

A flexible compensation package will, once and for all, put behind us the day when benefit plans provide more than you want but less than you need.

A Corporate Response: The TRW Experience

Shirley A. Curry

There has been much written about *cafeteria benefit plans* in both the professional and popular press. Conceptually, a cafeteria or flexible benefits plan permits employees to individually elect their level of benefits within a prescribed cost. Only a few companies have implemented this type of plan and have experience with the concept. TRW was the first major U.S. employer to implement a plan that permits employees to make trade-offs between direct and indirect compensation.

In November of 1969, TRW initiated a project to research the feasibility of cafeteria benefits plans. This project was undertaken by TRW Defense and Space Systems Group (DSSG) headquartered in Redondo Beach, California. TRW DSSG was and is primarily an aerospace contractor. At that time, it employed around 15,000 employees. Most employees were located in Redondo Beach, but there were sizable groups in San Bernardino, California, Florida, Texas and the Washington, D.C. area. Smaller groups were scattered across the country.

Discussion of the concept of cafeteria-style benefits in academic literature had started at the beginning of the 1960s and stemmed from early research in employee preference and motivational theory as it related to compensation. TRW originally joined with a number of other employers in an attempt to research and develop this concept as a joint endeavor. While a number of these employers expressed interest in the concept, none of them, except TRW and Educational Testing Service, a nonprofit organization, were able to devote the resources needed to fully explore the concept.

Why at TRW

Cafeteria benefits seemed to uniquely fit the culture of the Defense and Space Systems Group. A number of innovative approaches had already been adopted by the management of this organization. Sensitivity training and other organizational development approaches had been used to develop an environment which supported active problem solving by employees at all levels. Unlike many organizations that used some of these management and human relations tools, these approaches were not simply experimental—they were actually integrated into the culture of the organization.

Employees were accustomed to being involved in research projects, since most of the government contract work done by this organization was and still is related to research and development. The work force was organized in a very complex matrix. Work was organized around project assignments and dual reporting relationships were common. Subsequently, emphasis had been placed on developing communication channels both up and down and laterally. Interpersonal problem solving, sensing sessions and team building were essential features of management's philosophy of involving employees in the analysis of problems and the development of solutions. Another integral part of DSSG management's philosophy was that compensation was made up of both direct pay and benefits, and the two could not be managed independent of each other. The concept of cafeteria benefits was particularly applicable to this philosophy of total compensation.

There were other reasons for management entering into the research and development of a cafeteria benefit plan. First and foremost, it was felt that this type of program would have a positive impact on employee relations. Second, while reduction in cost was not an objective, it was felt that the introduction of this type of program would eliminate the follow-the-leader approach that is often prevalent in industry. Finally, while there was no proof, it was felt that this type of program would have better links with increased motivation and productivity.

A number of problems were anticipated at the beginning of the project. Many of these are the same concerns voiced today about this method of providing benefits: (1) adverse selection would kill it; (2) it would be an administrative nightmare; and (3) tax and other state and federal regulations would not support and permit the development of the concept.

Plan Development

A cafeteria benefit plan called flexible benefits was implemented at TRW in mid-1974. Over four and one-half years elapsed between the time the feasibility study was initiated and the plan was implemented. This is an unusually long time to research a benefit program, but it is important to recognize that nothing was known about how this concept would work in actual practice. While many companies at that time, including TRW, offered employees the opportunity to participate in contributory plans, there was no experience with plans which permitted employees to make trade-offs between benefits. No one knew how to design, administer, communicate, or fund a flexible benefits plan. Another consideration was that all of the effort to develop this concept was done internally as added assignments. The only exception was the use of a consulting industrial psychologist to develop the employee sensing methodology.

Once management's support had been committed to the project, a team of internal specialists was developed. This team included members from compensation and benefits, management systems and business finance sections. The project consisted of a number of segments:

(1) design of the benefit choice package;

(2) policy decisions and interpretation;

(3) funding and insurance procurement;

(4) tax and legal analysis;

(5) systems design and implementation;

(6) administration;

(7) communication and training;

(8) government relations.

For purposes of this paper, the focus will be on plan design, administration and communication.

Designing Choices

The design of a benefit choice package required the selection of the benefits to be included, the number of options within each benefit and the method by which employees could generate credits. Basic to the development of the DSSG plan was the information collected from employees.

Information was collected through a series of questionnaires. Step one was an attitude pretest. This test determined employees' attitudes toward the benefit package in effect, the administration of benefits and the company in general. The attitude pretest showed that most employees were relatively satisfied with their current compensation and benefit program and indicated that morale was generally good.

The issue of morale was particularly important since DSSG was in the midst of a major layoff.

A few months later, the first compensation choice questionnaire was distributed to employees. As a result of this questionnaire, we learned a number of things about employees' reactions to a system of choice:

— almost everyone changed something in their package;

— people liked the process and the opportunity to manage their total pay package to more adequately fit their personal needs;

— all kinds of people in all pay plans and categories were able to make serious decisions regarding the shape of their compensation package.

Two more questionnaires were administered to employees during the feasibility stage of the project. These two questionnaires were used to refine the plan design and benefit specifications.

Management's objectives for compensation and benefits were an equally important aspect of the design of the plan. An issue then, as it is today, centered around the concern that employees would trade away a benefit that they should have kept for security reasons, and the company would be faced with a weeping widow whose husband had elected to eliminate all his life insurance coverage, or a gravely ill employee who had elected reduced health insurance coverage. Because of these concerns, a decision was made to require each employee to elect at least a minimum level of life and hospital/medical insurance. Additionally, it was important that the flexible benefits package satisfy management's desire to maintain a competitive position in terms of attracting good employees.

After considering the information gained from the employee questionnaires and management's objectives, it was decided to include health insurance, life insurance, supplemental accidental death and dismemberment benefits and dependent life insurance in the flexible benefits plan. Other benefits, such as long-term disability and dental care, were to remain outside the package until some later time when independent decisions about including these benefits could be made. It was also decided that there should be no reduction in benefits as a result of the introduction of this program. Consequently, the pre-flexible benefits' noncontributory health insurance and noncontributory life insurance became the company's standards. Health and life insurance options costing more or less than these standards were made available to employees.

The TRW approach to cafeteria benefits permits employees to select the standard health and life insurance benefits and, thereby, make no changes in the ratio between direct pay and benefits. If the employee selects a less costly option in one category, a credit is generated. This credit can be used to purchase additional benefits in the other category, to purchase supplemental accidental death and dismemberment or dependent life, or the credit can be received in cash. If the employee selects *more* costly options in both categories, the increased costs are deducted from pay prior to the computation of Social Security and federal income taxes. If the employee selects *less* costly options in both categories, the credits generated are converted to cash. For example, if an employee elects one of the less costly health care plans, the credit that is generated can be used to purchase additional life insurance or a purely contributory benefit such as supplemental accidental death and dismemberment, or the credit can be received as cash, which would be considered taxable income.

Concurrent with the development of the benefit choices to be offered and the basic construction of the plan, a number of policy decisions and interpretations were being made. A thorough review of policies was a major factor in developing the program, since these policies were the general underpinning on which benefit administration was based. If the policies had not been modified to reflect the implementation of a flexible benefits program, the administration of the program would have been unduly complicated. Policies that were affected were unpaid leave of absence, salary continuation and vacation policy.

The modification of related policies may be the hidden parts of the iceberg in designing and implementing a flexible benefits program. Part-time employees who work at least twenty hours a week are eligible for benefits while temporary employees are not. Additionally, there were a number of policies permitting various types of paid and unpaid leaves. Each of these policies permitted the employee to continue his or her benefits for a certain duration, sometimes at company expense, other times at the expense of the employee. Each of these policies had to be carefully examined to determine the impact of the flexible benefits plan and modified to be consistent with the concept of the plan.

I will not attempt to address the many questions or concerns regarding adverse selection in insurance underwriting. Several safeguards to adverse selection were built into the system and one was required by the State Insurance Commission. It had been management's plan to allow employees to make any selection of benefit they chose during the initial enrollment period. The State Insurance Commission, however, required that employees who wish to enroll in higher levels of life insurance show evidence of good health. An abbreviated statement of good health was developed and used for this purpose. Included in the plan design were provisions that limited the amount of life insurance available to employees with less than one year of service. Employees who wish to increase the amount of their life insurance or switch to the high-option hospital/medical plan after their initial selection must also show evidence of good health.

The tax and legal issues were as complex as the insurance underwriting rules. They were not, however, anticipated to be a major problem when this plan was being designed and developed. At the eleventh hour, concern about this type of program was raised and there was an effort to abolish the tax basis on which it was constructed. TRW was successful in obtaining a legislative provision which grandfathered the plan implemented at DSSG. However, for a number of years, TRW was not able to extend the plan to other units. More recently, there has been favorable general legislation in this area.

Program Administration

The administration and supporting management systems needed by this type of program are often cited as the major stumbling blocks to implementation. Both of these areas required a great deal of effort before the program could be implemented at TRW. A major factor, however, was the size of the organization. The plan was designed and implemented by a group employing 11,000 people (currently 17,000) and the requirements for this size organization are considerably different than those of smaller organizations. Also, the whole area of management information, both software and hardware, has made tremendous advances since the time the plan was implemented. At TRW DSSG, it was necessary to modify the payroll system to provide for the pretax deductions and additions that could result from individual employee selections. Fortunately, a new employee information system was being implemented, and it was possible to add a number of the requirements for flexible benefits to that project. In the area of the day-to-day administration, only a few new processes were added.

As a part of the new administrative process, it was and is necessary for employees, each November, to select their benefit choices for the following year. A major decision, in retrospect, was to advise employees annually of benefit choices available to them and the corresponding cost, but to require them to reenroll only if they wished to change their benefit option(s). Over time, this has significantly reduced the administrative burden that is often cited as a necessary aspect of any flexible benefits program.

The annual enrollment process consists of providing a description of the options offered, an individualized worksheet and an enrollment card. During the initial enrollment, a hot line was established. For the first week, three people manned the hot line center. After the first week, and for the next three weeks, only one person was required. After the enrollment period, the employee's individual choices were recorded and a confirmation of the options elected were sent to the employee. In the event the employee determined that an inappropriate selection had been made, or the choices incorrectly recorded, an opportunity was permitted for change. During the initial sign-up, enrollment materials were mailed to the employee's home. This reduced the problem of materials being misplaced at work and prompted employees to share the decision about their benefit choices with their spouses. Even before the introduction of flexible benefits, an annual benefit statement had been distributed to employees. This was continued as an important aspect of the flexible benefits communications program. In subsequent years, the annual enrollment process has been almost identical to the process used during the initial enrollment. A hot line has not been used, but will be this year as a feature of a newly developed communication approach.

Between the annual enrollment periods, only new-hire employees are permitted to make flexible benefits selections. At the time of hire, employees are basically enrolled in the standard package. Within thirty days, they are sent an individualized worksheet and enrollment package from which they make their flexible benefits choices. While the time of one clerical support person is devoted to flexible benefits, the overall staffing level has generally remained constant both pre- and post-flexible benefits. In its steady state, the enrollment packets have developed into the basic communication tools. When initially implemented, however, other communications were used.

Communication and Training

Communication of flexible benefits started with the first employee questionnaires and continued throughout the process. In total, approximately 1,400 employees participated in the questionnaires conducted during the feasibility stage.

Prior to the actual implementation, primarily to determine insurance underwriting requirements, all employees were asked to participate in a preenrollment survey. This survey included samples of the materials that would be distributed in the final enrollment and described benefits and cost, generally the same as those offered at the time of implementation. This material was distributed to the home so that the employee could share it with his or her family. This 100-percent survey provided employees with an opportunity to practice using the forms and make choices without being bound by their actions. While done to satisfy underwriting requirements, in retrospect, its major value was as a learning tool.

Training had been conducted on an ongoing basis with the benefits staff and in more general terms with the various personnel representatives. There was no specially designed training session. Newspaper

TABLE 1
Hospital Medical Insurance Plan Provision

Coverage Features	Plan 1 Standard Plan	Plan 2 High-Option Plan	Plan 3 Comprehensive Plan
Semiprivate hospital room	120 days	365 days	After the yearly $250 deductible charge, major medical pays 80% of full reasonable charges for all of these services up to $5,000; thereafter, the plan pays 100% of full reasonable charges to a maximum of $100,000.
Hospital-miscellaneous	$450	Full reasonable charges for 365 days	
Surgery	Surgical schedule ($8.50 factor)	Surgical schedule ($10 factor)	
Laboratory and X-ray	Covered under major medical	Pays $100 full reasonable charges	
Supplemental accident coverage	$300	$300	
Psychiatric coverage	In hospital—120 days	In hospital—365 days	
Deductible charge before major medical payments start	$75/family member per year; $150/family per year	$50/family member per year; $100/family per year	$250/family member per year; $500/family per year
Maximum coverage limit	$25,000 per individual	$100,000 per individual	$100,000 per individual
Percentage of expenses paid under major medical	80%	80% of first $5,000; 100% thereafter to maximum	80% of first $5,000; 100% thereafter to maximum

articles, the enrollment package and the hot line were the basic communication instruments used during the initial enrollment cycle.

Flexible Benefits Offered in 1974

When the flexible benefits program was introduced at TRW, it included three hospital/medical plans, eight life insurance plans, dependent life insurance and a variety of supplemental accidental death and dismemberment benefits from which the employee could choose. Cash at this point was not permitted because of the uncertainty of how the plan would be treated for tax purposes.

The hospital/medical plans were all insured programs. The deductibles on these plans ranged from \$50 to \$250. The standard plan and the more costly option included basic benefits, while the less costly option was a straight comprehensive plan. Major medical maximums varied from \$25,000 to \$100,000 (Table 1).

The maximum of eight life insurance plans that were offered to employees ranged from one-half annual salary to five times annual salary. Benefits were payable in the form of a lump sum or a combination of a lump sum and survivor income benefit (Table 2).

A wide range of supplemental accidental death and dismemberment insurance plans were offered. Benefits to employees ranged from a low of \$25,000 to a high of \$250,000 (Table 3).

Also offered was the opportunity to enroll in dependent life insurance.

TABLE 2
Employee Life Insurance
Amount and Type of Insurance

	Single Payment	Survivor Income Annuity	AD and D Coverage[1]
Plan 1	1/2 annual salary	None	None
Plan 2	1 1/4 annual salary	None	1 1/4 annual salary
Plan 3	2 1/2 annual salary	None	2 1/2 annual salary
Plan 4	3 3/4 annual salary	None	2 1/2 annual salary
Plan 5	5 × annual salary	None	2 1/2 annual salary
Plan 6	1 1/4 annual salary	+ 1 1/4 annual salary	2 1/2 annual salary
Plan 7	1 1/4 annual salary	+ 2 1/2 annual salary	2 1/2 annual salary
Plan 8	1 1/4 annual salary	+ 3 3/4 annual salary	2 1/2 annual salary

[1]This coverage is *regular* accidental death and dismemberment insurance and is in addition to any supplemental accidental death and dismemberment coverage elected by the employee.

TABLE 3

Supplemental Accidental Death and Dismemberment Insurance Plans

	Employee Only A	Employee and Spouse B	Employee, Spouse and Dependent Child (Each) C
Plan 1	$ 25,000	$ 25,000 12,500	$ 25,000 12,500 5,000
Plan 2	50,000	50,000 25,000	50,000 25,000 5,000
Plan 3	100,000	100,000 50,000	100,000 50,000 5,000
Plan 4	150,000	150,000 75,000	150,000 75,000 5,000
Plan 5	200,000	200,000 100,000	200,000 100,000 5,000
Plan 6	250,000	250,000 125,000	250,000 125,000 5,000

Participation Experience

Perhaps not unsurprisingly, the actual enrollment patterns did not vary significantly from the 100-percent preimplementation survey done about six months before implementation (Table 4).

Implementation Analysis

Some general observations that can be drawn from the initial enrollment are:

— Over 80 percent of the employees made some changes in their insurance package.

— The 100-percent survey was an excellent predictor of the actual choice patterns.

— The only major problem with the plan design had to do with employees who selected choices that yielded a negative balance. These employees had selected an option plan which resulted in a credit, and the credit had not been used to purchase other flexible benefits. Because of the uncertainty of the tax laws at that time, there was a requirement that employees fully use their credits for other benefits.

Mid-year implementation added to the administrative burden because of the additional claim time required to recalculate the annual deductibles.

TABLE 4
Participation Comparison
Enrollment/100-Percent Survey

Hospital/Medical Insurance	Enrollment	100-Percent Survey
Plan 1 (standard plan)	40.1%	43.2%
Plan 2 (high-option plan)	55.3	49.3
Plan 3 (low-option plan)	4.6	7.5
Employee Life Insurance	**Enrollment**	**100-Percent Survey**
Plan 1 (1/2 ×)	3.0%	3.5%
Plan 2 (1 1/4 ×)	31.9	26.4
Plan 3 (2 1/2 ×)	46.7	43.5
Plan 4 (3 3/4 ×)	6.3	
Plan 5 (5 ×)	3.3	12.2[1]
Plan 6 (2 1/2 × - survivor)	6.0	
Plan 7 (3 3/4 × - survivor)	1.8	14.4[2]
Plan 8 (5 × - survivor)	1.0	
Dependent Life Insurance	**Enrollment**	**100-Percent Survey**
Do not want	32.6%	30.3%
Do want	67.4	69.7
Supplemental Accidental Death and Dismemberment Insurance	**Enrollment**	**100-Percent Survey**
Do not want	37.5%	36.4%
Want some option	62.5	63.6

[1]Different levels of lump sum and surivor income were offered in the 100-Percent Survey.
[2]Ibid.

Introduction of HMOs

In 1975, the first HMO was offered to the employees. This was Kaiser of Southern California. Since then, five additional HMOs have been added to the plan. Because of the geographical location of employees, each employee has available to them only one HMO, except Southern California where two are offered. Since they were first introduced, participation in HMOs has increased to a total of 22 percent of the total eligible employees (Table 5).

The percentage of total covered employees enrolled in HMOs presents somewhat of a distorted picture. A more significant comparison is the percentage of eligible employees who participate in these plans (Table 6).

The enrollment patterns in HMOs are interesting as employers often cite Southern California as a unique situation—one where HMOs are accepted and, therefore, where relatively high participation rates are not unusual or difficult to achieve. What is demonstrated by the enrollment patterns under the flexible benefits plan, is that in Georgetown the HMO, which services employees located in McLean, Virginia, and the Family Health plan, which services employees located

TABLE 5
Hospital/Medical Participation as a Percent of Total Employees Covered by Flexible Benefits

Hospital/Medical		1974	1975	1977	1979	1981
Plan 1	Standard plan	40.10%	39.60%	39.00%	40.30%	40.10%
Plan 2	High-option plan	55.30	50.40	43.20	36.50	33.70
Plan 3	Comprehensive plan	4.60	4.10	5.20	5.00	3.50
Plan 4	(Kaiser So. Calif.)	N/A	5.90	8.30	9.80	8.80
Plan 5	(Kaiser No. Calif.)	N/A	N/A	.03	.70	.70
Plan 6	(Maxicare)	N/A	N/A	3.90	6.30	9.50
Plan 7	(Georgetown)	N/A	N/A	N/A	1.40	1.60
Plan 8	(Health Net)	N/A	N/A	N/A	N/A	.60
Plan 9	(Family Health)	N/A	N/A	N/A	N/A	.50
Plan 10[1]	Low-option plan	N/A	N/A	N/A	N/A	1.00

[1]This plan was added in 1981 and has a $500 deductible per year per person and a $250,000 maximum.

TABLE 6
Flexible Benefits
Health Maintenance Organization
Enrollment Patterns

Plan Number	Years	Eligible Employees	Percent of Eligible Enrolled
(4)			
Kaiser So.	1/1/78	10,939	10%
	1/1/79	10,787	12
	1/1/80	12,100	11
	1/1/81	13,967	11
(5)			
Kaiser No.	1/1/78	176	33
	1/1/79	242	35
	1/1/80	256	43
	1/1/81	308	46
(6)			
Maxicare	1/1/78	10,221	5
	1/1/79	10,104	8
	1/1/80	11,328	11
	1/1/81	13,000	15
(7)			
Georgetown	1/1/78	450	29
	1/1/79	530	33
	1/1/80	610	40
	1/1/81	682	44
(8)			
Health Net	1/1/80	536	11
	1/1/81	703	15
(9)			
Family Health	1/1/81	211	42

in Utah, achieved higher initial enrollment penetration than did either Kaiser of Southern California or Maxicare, which also serves Southern California. While participation in any HMO during 1981 resulted in a credit, which employees can use for other benefits or receive as cash, this has not always been the case. Yet, participation patterns clearly demonstrate that HMO enrollment has progressively grown whether a credit or a charge is made for enrollment in the benefit. A more significant factor in the acceptance of HMOs may be the support they have received from management.

In 1981, a new life insurance program, which provides a flat $5,000 benefit, was added to the plan. Plan 2, which provides 1 1/4 times annual pay, is the company's standard plan and is the same as the noncontributory benefit in effect prior to the introduction of flexible benefits. Employees may select this option without charge or credit. Plan 3, which provides 2 1/2 times annual pay, is equal to the total contributory and noncontributory benefit available prior to the introduction of flexible benefits. Plans 2 and 3 have consistently received the bulk of the participation. However, it is apparent from participation patterns that employees do make changes. Whereas Plan 3 was the most popular choice in 1974, today Plan 2, the company's standard plan, attracts the greatest number of participants. While the other plans do not attract the same magnitude of employees, the percentage of employees selecting these options has varied from year to year. Whether these subtle shifts reflect a change in the needs of individual long-term employees, or a change in the needs of newly hired employees, we do not know. We do know, however, that the participation patterns have varied from year to year (Table 7).

Since January 1979, employees have been able to make selections which include a cash payment. Unfortunately, the one piece of data we have not tracked, is the number of employees who make selections that result in more direct pay and reduced benefits. Employees have told us that where their spouse is insured through another plan, or even through the flexible benefits plan, they select the low-option health care plan, so they can receive the difference in cash. We do know that younger employees do not tend to select the higher levels

TABLE 7

Employee Life Insurance Participation as a Percent of Eligible Employees

	1974	1975	1977	1979	1981
Plan 1 (1/2 ×)	3.0%	3.3%	3.4%	3.1%	3.3%
Plan 2 (1 1/4 ×)	31.9	33.2	34.0	35.0	43.9
Plan 3 (2 1/2 ×)	46.7	45.3	41.5	38.1	31.3
Plan 4 (3 3/4 ×)	6.3	6.2	7.3	8.5	7.4
Plan 5 (5 ×)	3.3	3.2	4.3	5.4	4.6
Plan 6 (2 1/2 × - survivor)	6.0	6.0	5.8	5.4	4.8
Plan 7 (3 3/4 × - survivor)	1.8	1.8	2.3	2.9	2.9
Plan 8 (5 × - survivor)	1.0	1.0	1.4	1.6	1.4
Plan 9 ($5,000)	N/A	N/A	N/A	N/A	.4

of life insurance. In 1977, we were able to determine that married employees tended to stay with a standard package or an improved package. It is our belief that many of these employees have since switched to an HMO. Participation in the high-option hospital/medical plan is the most reduced since the introduction of HMOs. If these assumptions are true, then the 4 1/2 percent of employees participating in the two low-option insured hospital/medical plans—both of which generate credits—are probably drawn from the ranks of the single employee or married employee whose spouse also has hospital/medical insurance.

Evaluating the Flexible Benefits Program

To obtain a thorough evaluation of the program and its success at meeting these objectives, we have undertaken a study to measure the results of the program against the original objectives. We do not know yet if the flexible benefits plan has been successful in meeting its original objectives. We do not know if it has improved employee relations or if employees perceive it as a good thing to have. We believe we have been successful in breaking the follow-the-leader pattern. It is our hope that this study will be completed by the end of the year. We have some important information to date, though.

First, and perhaps most importantly, employees can make complex decisions. I believe this has been demonstrated by the relatively few requests that we receive during the year to make changes in the benefit program. As a matter of practice, changes are not permitted except at the annual enrollment period. We also think we can support a finding that participation in an HMO is based on something other than the ability to obtain a credit; since, over time, enrollment in HMOs has increased steadily—even in those years when a charge was made for participation. I believe it can be demonstrated that administration of these plans does not have to be a tremendous burden or an insurmountable obstacle. An informal survey of those people who actually administer the plan on a day-to-day basis resulted in comments that this plan was no more difficult or created no more problems than traditional benefit programs. These same people report that employees really do understand their benefits better.

Changes in participation patterns, while in some cases modest, do reflect that the needs of the employee population shift from year to year. I also know that to establish one of these plans, you must have top management support if completion of the project is to be done in a reasonable time frame. I also believe that employee involvement in the initial feasibility stage is an essential component. I do not know whether there has been adverse selection. If adverse selection means employees selecting something that they anticipate they will use, that seems reasonable. It is not rational to expect an employee to select something that he or she never expects to receive any value from; but we do not have evidence that only those who are chronically ill or have a history of medical problems select the higher option plans. There are any number of other reasons why employees might select the high-option plans. Perhaps, they have a number of small children. Perhaps, they are planning to start a family. Realistically, many of them may be very fearful of the financial impact of major illness based on the press coverage given to the high cost of health care. It is my firm belief that this concept is more viable today than it was in 1969, when we first started our feasibility study.

Consider all the changes that have occurred and have placed pressure on employers to provide a variety of benefits. Inflation has been at a double-digit figure for several years. Health care costs have risen even faster than the general inflation rate. Fewer males now provide the sole support for their family. More than half of all adult females work. Of those females born in the late 1950s, almost 70 percent are working. In the 1980s, the number of female employees in the twenty-five to forty-five age group is expected to increase by 35 percent. Some couples are electing to remain childless, and those that do become parents have considerably smaller families than their parents. Single households have grown in number. At the beginning of the 1970s, married households made up to 70 percent of all households. Today, only about 60 percent of all households are maintained by married couples. Retirement age can no longer be mandated at sixty-five. While most employers have not reported any significant shift to higher retirement ages, continual inflationary pressures on the general economy and on Social Security may change this trend in the near future.

Legislation, Regulation and Flexible Benefits

On the legislative front, there has been a number of significant changes that support the expansion of flexible benefits programs. The 1978 Revenue Act defined *cafeteria* plans, established the criteria under which they could be implemented and clarified the tax situation. The 1978 Act also established the criteria and taxability of qualified cash and deferred profit sharing plans. The Miscellaneous Tax Act of 1980 established criteria for including a qualified cash and deferred profit sharing plan in a cafeteria plan. It also eliminated many of the tax issues that affect constructive receipt, and it provided that day-care services sponsored by an employer will not be taxable income to the employees. Social and legislative trends have established a climate that is ripe for the expansion of flexible benefits.

Potentially, an opportunity exists to design and implement a program that will include insured welfare-type plans—medical, life, dental, qualified cash and deferred profit sharing plans (e.g., stock, savings or thrift plans), cash and other options such as vacations, holidays and child care. Realistically, employers must limit the number of options that they can provide based on the size of their organization and their ability to administer the plan. Larger organizations, however, should not find multiple options disadvantageous if a reasonable number of employees can use them. I believe a plan that includes all these options can be designed to meet various employee needs and yet stay within the bounds of reasonable cost and administration. It should also reduce some of the employee pressures for unique and specific benefits that satisfy only a small segment of the population's needs. In this way, it should help to reverse the trend of designing benefit plans to meet the needs of the married male with children.

A plan that includes all these options would permit: (1) the working mother to trade off an unneeded benefit for some assistance with child care; (2) the older employee to prepare for his or her retirement; (3) the unmarried employee to trade unwanted life insurance for more vacation; and (4) the two-career family to adjust benefits to satisfy need rather than being stuck with too much of one benefit and too little of another.

Conclusion

Cafeteria benefits are not appropriate for all employers. Of those who could benefit from cafeteria plans, the TRW approach may or may not be appropriate. Each company must examine its objectives and the needs of its employees. Then, having considered all the facts, companies must design programs that fit their unique situations. Hopefully, the future will not mirror the past, and we will find creative ways of designing benefits to meet individual needs instead of providing what we think the average employee needs.

Forum Discussion

Relationship of Flexible Benefits Plans to Employer Costs

MS. BOHEN: What is the relationship between flexible benefits and employer costs?

MS. CURRY: We did not establish a flexible benefits program to contain costs. I am not saying this is not a legitimate reason in today's environment, but this was not our objective and we did not build it into our system. We are going to look at our benefit levels and try to determine whether we have increased them faster or slower than our competition.

MR. HASLINGER: I want to add strong agreement with that. The American Can plan was not implemented in any way, shape or form for cost containment. It was done to address what we perceived to be the needs of our employees and to provide them with a richer plan.

MS. KRICKUS: Is there a way to look at figures on turnover or absenteeism or other similar measures?

MS. CURRY: As part of our extensive evaluation study, we began to consider such factors and gave up on it. There are too many factors to consider. For example, we had personal days and unpaid days prior to the implementation of flexible benefits and flex time. Each of these features could have some effect on absenteeism.

MR. HASLINGER: We have the same problem.

MS. CURRY: I think flexible benefits assist in reducing turnover, but I don't think you can isolate it.

MR. HASLINGER: When we talk about flexible comp, we're talking basically about continuing the same amount of credits while giving the employee a choice of taking a certain amount either in cash or in benefits. It doesn't cost the company any more. It just gives the individual a greater degree of control over the makeup of his compensation package.

Reasons for Creating Flexible Benefits Plans

MS. AXEL: What will cause employers to create these plans?

MS. CURRY: I don't think employers establish flexible benefits plans only because this is good for the employees. We thought it would improve productivity and improve employee relations. I think there are a lot of companies that are working to develop flexible programs, because they cannot continue to provide every employee benefit that is demanded. There's too much change and too many new needs. There's not enough money to go around. I think this is what will cause employers to establish these plans.

MS. RAPPAPORT: I would like to respond to the question about why employers will change programs in the future. Although employers will not necessarily go the flexibility route we have seen so far, there is a very basic reason why they will have to change. It is because the results we are experiencing in the work place today really are not satisfactory, either to the employers or the employees.

Employers are paying in the form of poor productivity, and employees are paying for that poor productivity in the form of flat earnings. In addition, some significant part of compensation is not meeting the real concerns of many employees.

Accommodating the Single Worker and the Working Parent

MS. NADEL: How will day care fit into flexible benefits programs?

MR. HASLINGER: In 1978, we began studying the possibility of providing day care as a traditional benefit. We ran into a problem that I think a lot of corporations will run into unless they go the flexible route. About 20 percent of our employees were extremely aggravated, because they felt this was just another extra fringe for married employees with children.

MS. CURRY: I think that is what will create it. You have a lot of people who want and need day-care benefits, but you're going to have a backlash if it is provided as a general benefit. I think the single person has yet to be heard from.

MS. SKELLY: Zale Corporation of Texas has on-site child care on a self-liquidating cost basis. In other words, an employer's participation in child care does not necessarily mean a total outlay of cash or vouchers. Through group rates, they were able to make excellent on-site child care available at a fraction of an individual's cost. The consensus there was that only through flexibility and trade-off could child care be effectively offered without engendering the unfairness thrust.

MS. RAPPAPORT: Under traditional benefits programs, the benefit dollars are allocated relatively heavily to one segment of the work force—those who have dependents. Dependent coverage is relatively expensive and usually heavily subsidized. If you're going to go to a system where the benefit money is allocated fairly among all segments of the work force, the employer is faced with one of two choices: either reducing significantly the benefits of those who have gotten relatively more, or spending significantly more money. It seems like both options are unpalatable to most employers.

MS. CURRY: We always were on a composite basis, and that's how we continue to cost our credits and our charges. Whether you are single or married, you are assumed to cost the same amount.

Are Employee Benefits Plans a Contract?

MS. SKELLY: I would say that there are a couple of things in our work with employees, and with the human resource community more generally, which suggest there may be in the offing some real changes in whether there is prior definition and a real contract on benefits.

If this notion of commitment to increasing profits starts to become a predominant force, if the erosion of the egalitarian spirit continues, and if there is more fear in the contract employers make with their workers, I think the definition of benefits will be less clear. Rather, benefits will increasingly be used as incentives—incentives for performance. This is a very different kind of use than we have traditionally seen.

I am only saying that there are embryonic signs of several of the themes I have enumerated. I am not saying that companies are all getting together somewhere on a mountaintop and planning this all out. But certainly, we have started seeing these themes. I think it behooves those of us in the benefits business to at least watch this development.

The Effect of Unions on the Nature of Employee Benefits

MR. HASLINGER: I think you have to consider the potential effect of unions. Should unions make inroads into the white-collar work area, any chance of benefits becoming an incentive instead of a fringe does not strike me as being probable.

MS. SKELLY: Except that the union movement is in the position of a marketer with a shrinking share of the market—26 percent down to 19 percent. The attitudes of union workers are not much different from the nonunion group.

MR. HASLINGER: I think I have to totally disagree. If unions do not refocus away from the traditional blue-collar union workers, the strength of the union is likely to diminish to the point of being meaningless. But the circumstances are not that different from the circumstances that existed when unions initially rose to power. And, if they can redirect their energies and capture the white-collar worker, I think you have a very good chance of seeing a strong union movement.

MS. SKELLY: That would be fine, except for the strong sense of individuality that younger workers have about themselves, which is not as conducive to solidarity forever, as was the case under a more conformist culture.

The Mix of Defined Benefit and Defined Contribution Plans

MR. SALISBURY: To what degree might these trends accelerate movement away from defined benefit plans? Will defined benefit plans continue to be a core benefit?

MR. HASLINGER: I think from American Can's point of view, at least in the near future, you are not going to see us do away with the defined benefit plan. Competitive pressures alone are too great.

Employees are becoming very sophisticated at this point. They understand Social Security offsets and plan differences. Movement to a defined contribution plan, or some kind of a defined flat dollar plan, would be a major problem. But, I think the issue will have to be addressed at some point, because a defined benefit plan based on final average earnings may become unaffordable.

MS. CURRY: I don't think we would include our defined benefit pension plan in our flexible benefits plan. I think we are placing more emphasis on our defined contribution plan as a supplement. I think we are trying to look at that interplay, but we have to have a defined benefit base of some type.

MS. RAPPAPORT: I think defined benefit plans are here to say, at least for the next decade. Now it is definitely true that they do not work for everybody. They do not work for people who move in and out of the labor force a lot.

I do see the mix between defined benefit and defined contribution plans changing. We are developing replacement studies on employers who have both types of plans. We combine the defined benefit plan, Social Security and the defined contribution or thrift plan. The employer is increasingly recognizing the mix.

In some instances, only a small portion of an employer's workers remain with that employer throughout their careers. In such cases, employers are concerned about short-term incentives. I have a client who is very likely to move from a traditional defined benefit plan to a defined contribution plan with a minimum benefit. The employer is very concerned about incentives and wants to take care of the long-service people in the traditional manner. However, the employer also wants to do something to motivate managers in the field, because in the short term, the business depends on these managers.

I do not really see traditional benefits in conflict with incentives and productivity. I do think we are going to have to design them somewhat differently and pay attention to these issues.

MR. CALVERT: I support what Anna said. I want to point out that in Canada there has been a trend toward preserving the defined benefit plan and backing it up with a defined contribution plan. These two are not in conflict.

MR. PAUL: First, we have talked a lot about the life cycles of people, but not very much about the life cycles of businesses. It is traditional that a business will not take on the obligation of a defined benefit pension plan early in its life, because its profitability may still be subject to large fluctuations. Young businesses may not be willing to commit themselves to long-range pension costs.

Second, if we are going to experience the phenomenon of lots of small businesses growing up, run by highly educated, highly motivated people who have entrepreneurial spirit, these are the people most likely to think of incentive stock option and profit sharing plans (defined contribution plans) and not defined benefit plans.

Third, today, most new businesses do not face the problem that most pension plans faced in 1950 when the pension plan movement began—lots of past service. If Company *A* starts tomorrow, it's not terribly concerned with past-service problems. Replacement studies indicate that if you can put aside 7 percent of pay over a long period of time, you do not get a benefit very much different from what a 1-percent final average salary plan provides. You are not really talking about differences, you are talking about degrees. I think that you will see a mixing of defined benefit and defined contribution plans.

Fourth, to the extent that careers are shorter and people are in and out more and more, employers are thinking more and more about supplementing their defined contribution plans and not supplementing their defined benefit plans.

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Welcome and Introduction

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The EBRI Education and Research Fund sponsored a policy forum on November 10, 1981 entitled, "The Effect of Changing Family Relationships on Employee Benefit Programs." Employee benefit professionals, public opinion experts and futurists attended. Speakers made presentations on changing trends and values in America and their impact on Social Security and employee benefit programs. Selected speaker presentations and the edited forum discussion are compiled in **America in Transition: Implications for Employee Benefits.**

The material in this volume explores the following topics: (1) changing demographic, workforce, attitudinal and technological trends; (2) the implications of these trends for employees, employers and public welfare institutions; (3) experiences with new benefit approaches, e.g., flexible benefit programs; and (4) the costs and benefits of such approaches for employers and employees.

This publication also includes a bibliography on flexible benefit programs.

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