The Inflation Gap in Employee Costs
Update to Sept 30, 2012

At last report, as of last March, I wrote

> *The familiar data on employment costs – the Employment Cost Index reported by the Bureau of Labor – provides some very sobering insight into the effect of inflation over the last fifteen years. The numbers tell all, and I will provide them in a moment, but the story is so simple and graphic that no higher math is really needed. In words, wages and salaries have grown slowly – falling steadily behind the cost of living – while the cost of fringe benefits has soared.*

Nothing has changed fundamentally, but the latest data shows a steady worsening of these trends, and it is to that recent record that I want to turn now. The table below is updated three September, but in this case the period covered states at the end of 1999. It there focuses on the extremely poor performance of the nation since the start of the recession of 2000.

	Growth Rate of Wages & Salaries	Growth Rate of Fringes[1]
All Civilian Workers	2.6%	4.3%
Private Industry Only	2.6%	4.3%

For both categories, total compensation rose at a rate slightly in excess of 3%. The history covers the twelve years from the end of 1999 to the end of September, 2012.

The Difference between Wages and Fringes

To recap, I stated the most recent with some background, that I will simply repeat here. As far as the employer is concerned, there is no difference between wages and fringes. Both are employment costs. In the case of accruing pension obligations, there is small and sometimes important difference derived from the fact that a rising stock market can pay for the pension promise entailed by defined benefit plans, and a falling market must be made up in defined benefit plans by the employer, so the cost of the pension

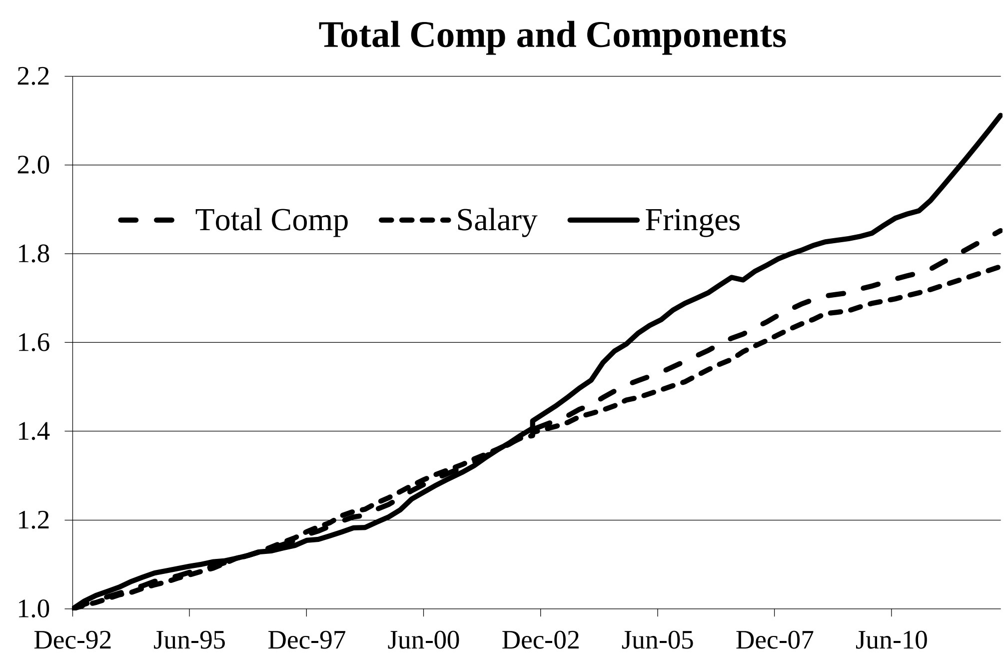
[1] Fringe benefits are dominated by employer-provided medical insurance and provision for pension benefits.

promise in any given year is a random variable. Total fringes however are dominated by medical insurance and contributions to defined contribution plans, both of which are fixed by the employment contract. So, with the small adjustment for topping up defined benefit plans, the employer knows only the total cost of wages and fringes combined.

As far as the ***employee*** is concerned however, wages are his and fringes are someone else'. He will eventually collect his pension, but not generally for a long time. More importantly, he will collect his defined benefits if – a big if – he stays with the same employer. That rarely happens in America today, and defined benefit plans have become a very cheap form of compensation for employers, but that misses the point. Employment turnover has made defined benefit pension promises a fantasy to a shocking extent. In any case the largest part of fringes are medical insurance. That component of employment costs are a cost to the employer but they are not income of the employee. Stated bluntly, the employee views the fact that when he needs to he can go the doctor and let his insurance pay. That is a real benefit. But the doctor and the hospital have raised their charges and the treatment is now more expensive, that is not in any sense a greater benefit to the employee. It is just a cost to his employer.

The bottom line is that higher pay is a benefit, but higher fringes are purely a cost. Few workers would be impressed by the following promise from their employer:
We can't afford to raise your pay right now, but we'll do this – if you get sick we'll give your doctor a raise.

The wellbeing of working America has been lifted at the growth rates of wages and salaries, but employment costs have been rising a higher rate that reflects inflation of medical costs too. This has been going on for a long time: for decades.



Where has decade of inflation in the fringe benefits taken us?

Taking December, 1999 at the starting point, with all indices set to 1.0 by definition, the index of Private Sector wages has risen 40%, 1.402, in nearly twelve years. But the index of Fringe Benefits is up 73%, to 1.727. If the employees' wages had kept track with their fringe benefits, their pay would be about 23% higher today, and they would have been earning getting bigger raises for more than a decade.

This hypothetical is of course just a pleasant reverie. The fact is that wages have not grown very fast – 2.5% -- precisely because their fringes have gobbled up the lion's share of their higher productivity, measured in nominal terms. Sixty years ago American workers were chastised – or their employers were chastised – for surviving as Wage Slaves." Well, they're now Fringe Slaves, chained to the fringe benefit wheel.

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