DRAFT

CAFETERIA COMPENSATION/FLEXIBLE BENEFITS/

FLEXIBLE COMPENSATION

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INTRODUCTION

Cafeteria compensation/flexible benefits/flexible compensation--these are names given to programs in which individual employees have some choices in the ways in which their total compensation is received. The term total compensation includes pay plus benefits. Benefits include such items as vacation, sick leave, paid holidays, pensions, life insurance, health insurance, long term disability, profit sharing, savings and thrift plans, etc.

In the last two decades, benefits have become an increasingly large portion of the total compensation package. In many large firms, employer expenditures on benefits amount to 30, 40, or even 50 percent of basic pay. These are significant corporate expenditures. Under a system of standardized benefits used by almost all companies, everyone on the payroll is treated the same--as the "average employee." This kind of system does not take into account that individual workers' needs differ. Dunn and Bradstreet reports that as a result, some of the benefits in today's standardized plans waste corporate dollars. A company can find itself paying more each year for a benefits package that only partly satisfies the needs of the bulk of its employees.[1/]

In 1975, the ASPA prize for the best personnel research was awarded to Drs. Chapman and Ottman for their article "Employee Preference for Various Compensation and Employee Benefit Fringes." This research concluded that any attempt to individualize an organization's reward system should have a positive effect on employee satisfaction. Organizations which emphasize the individualizing of their compensation systems as much as possible will be in a better position to attract and hold an effective work force.[2/]

Flexible compensation can help a company spend its pay and benefits monies more cost-effectively. Companies get more value for monies spent in terms of greater worker satisfaction. Greater worker satisfaction and cost-effectiveness can result in increased productivity.

TYPES OF FLEXIBLE PROGRAMS

Hewitt Associates, a firm of independent consultants and actuaries in compensation, employee benefits, communication and other related personnel functions, points out that flexible programs are not new. Many existing corporate benefit programs have some degree of flexibility. Hewitt divides flexible programs into three categories:3/

-1- The employer provides a basic benefits program that applies to all employees. Employees can choose to buy optional coverage with deductions from their take-home pay. The employer provides the advantage of group purchasing power. Employees pay the full cost of any optional coverage they select (e.g., the Federal Government's optional life insurance program).

-2- The employer provides a supplement to the basic benefits program. The employer and the employee share the cost of the supplement. Employees can choose whether or not they wish to have the supplemental benefit. (The Federal Government's regular life insurance and health benefits programs fall into this category. The employer pays 1/3 of the life insurance cost; the employee pays 2/3. For health insurance the employer pays approximately 60 percent of the unweighted average of the high 6 designated plans, but not to exceed 75 percent of the total premium; the employee pays the remainder.)

-3- The employer provides a core of basic benefits for all employees. The employer also provides and pays for a supplement to the basic benefits core. The employer offers the supplement to all employees in the form of flexible credits. Employees choose, from a number of options, what they want to buy with their flexible credits. Flexible credit choices require no deductions from take-home pay. If employees want to choose more options than their flexible credits cover, then they can pay for the additional options by deductions from their take-home pay. Employees always receive the value of the employer's contribution to the supplemental benefit program. (The programs at American Can, TRW, and ETS fall into this category.)

The third type of flexible compensation program is the newest. The remainder of this paper is devoted to it. The paper will explore what has happened in the past two decades; the basic designs of flexible compensation programs; the steps needed to set up a program; common problems and solutions; and why companies are interested in cafeteria compenstion plans.

The staff papers which will follow this one will deal with whether or not a cafeteria compensation concept is compatible with the total compensation comparability (TCC) concept and experimental designs that could be pursued by putting the two concepts together.

THE LAST TWO DECADES

1960-1974

The idea of flexible compensation programs in which employees could choose from among a variety of employer-paid benefits emerged in the early 1960's. The idea fascinated experts in compensation, psychology, economics and in the business and academic communities. They lectured; they discussed; they wrote articles. Yet, until 1974, nothing happened except talk and writing. Why?

We may infer, from reviewing the literature and questioning the experts that the interacting causes of the inertia were:

- the complexities of the actual design, test and implementation of a flexible compensation program in a corporation boggled the mind;
- the computer hardware costs were high and software knowledge advances and applications were largely directed to the fields of science and engineering;
- the compensation experts were busy at work structuring very basic benefit programs where none existed before, e.g., witness the rapid growth of benefits in this era, particularly health care;
- the lack of a strong industrial relations program; or
- the concept of flexible compensation was untried and untested; this may have led to practical decisions to put corporate investments elsewhere until some leaders emerged and the followers could benefit from their experience.

1974-1978 The Tax Question

In 1974 the passage of the Employee Retirement Income Security Act (ERISA) dealt some deadly blows to flexible compensation. ERISA's provisions and reporting requirements were very complex. Bringing retirement programs into compliance with ERISA was a high priority item and absorbed the time of compensation planners. ERISA also essentially froze the implementation of any new flexible compensation programs. ERISA allowed the continuance of flexible benefit programs in effect in 1974, but prevented new plans by providing that if employees had a choice between taxable and nontaxable options, the employer contribution was required to be included in the employee's income to the extent that the employee could have elected taxable benefits. The purpose of the freeze was to give Congress an opportunity to study the tax question.7/

The Revenue Act of 1978 was a major breakthrough for cafeteria compensation plans and a very significant development for compensation planning for the years ahead. In the area of flexible compensation, the Act provided that:

- employer contributions under a cafeteria plan which permits employees to elect between taxable and nontaxable benefits are excluded from the gross income of an employee to the extent that nontaxable benefits are elected;

- nontaxable benefits include group life insurance up to $50,000 coverage, disability benefits, accident and health benefits, and group legal services;

- plans must be nondiscriminatory, i.e., everyone with 3 years of service must be eligible, total benefits must be an approximately equal percentage of pay, and health benefits available to lower paid employees must be at the same price as for higher paid employees.

Consistent with good legislative drafting the Revenue Act of 1978 defined cafeteria plans in law. Sec. 125(d) states:

> "(d) CAFETERIA PLAN DEFINED.--For purposes of this section--
> "(1) IN GENERAL.--The term 'cafeteria plan' means a written plan under which--
> "(A) all participants are employees, and
> "(B) the participants may choose among two or more benefits.
> The benefits which may be chosen may be nontaxable benefits, or cash, property, or other taxable benefits.
> "(2) DEFERRED COMPENSATION PLANS EXCLUDED.--The term 'cafeteria plan' does not include any plan which provides for deferred compensation."

1974

This year marked the beginning of the newest type of flexible compensation program. The Educational Testing Service (ETS) and TRW were the first pioneers to implement new flexible compensation plans. The compensation world was agog.

At ETS, developmental work began at management's initiative in 1973, and the plan became effective February 1, 1974. At that time ETS considered itself to be trailing in benefits from where it wanted to be in the market place. ETS was very sensitive to the diversity of its employee groups by age and occupation and to their correspondingly differing needs. ETS decided, therefore, to keep its existing benefits as a core program of nonflexible benefits and to supplement it by about 5 percent of salary. The 5 percent supplement was in flexible credits that allowed individual employees the choice of how the flexible credits would be spent.

The ETS core benefits fully paid for by the employer consist of:

- Pension (TIAA/CREF): 6 percent of salary
- Life Insurance: 1-1/2 times salary
- Health Insurance: Blue Cross/Blue Shield for employee only
- Vacation: 4 weeks per year after 5 years; before 5 years dependent on salary and years at ETS
- Sick Leave: 9 days per year
- Accident and sickness plan for longer illnesses
- Long term disability plan

The options that flexible credits can be used to buy are:

- Added retirement (essentially a deferred savings plan) with the employee contributing 3 percent and ETS matching with 3 percent.
- Added life insurance and dependent coverage
- Dependent health care; dental, annual physical
- Added vacation (up to 2 weeks)
- Mutual funds
- Other retirement contributions
- Cash

ETS reports that the program has been good for cost containment. There has been no adverse selection, except dental which was anticipated. There have been few problems and no major opponents. Options selected have been quite consistent, especially in insurance and savings plans. Vacation options vary. Savings has been the most popular option, followed by vacation. Nineteen percent opted for cash when it was offered. Mutual funds were the least attractive option.

After 3 years, ETS is about to resurvey. Program changes are planned in response to survey findings. Flexible credits will be raised 1 percent next year. The core will not be reduced. As part of the long-term outlook, ETS is considering vision care and group auto options.

ETS advises that the computer system and its careful monitoring has been the key. Communication with and education of employees has been done well, and has not been a significant problem.4/

The current complete ETS plan is on file in the Office of Compensation Program Development.

1974 - TRW

In an attempt to broaden benefits in a cost effective manner, TRW began studying the concept of flexible benefits in 1969. TRW permitted salaried employees in the Systems and Energy components to choose among benefits for the first time in 1974.

Prior to 1974 TRW offered employees a standard Hospital/Medical Insurance plan for the employee and dependents and standard Life Insurance and Accidental Death and Dismemberment Coverage.

With the advent of flexible benefits, employees were allowed to trade up or down on their Hospital/Medical Insurance or to retain the Standard Plan. The choice of the Standard Plan resulted in no charge to the employee. A choice of the lower option resulted in a credit to the employee and the higher option resulted in an employee charge.

In the insurance area there were three options:

1. An employee could retain the standard insurance package. This option resulted in neither a charge nor a credit to the employee.

2. An employee could choose life insurance coverage only. This option resulted in a credit to the employee.

3. The employee could choose from among the following:

   a. Standard or increased life insurance;

   b. Standard or increased Accidental Death and Dismemberment coverage;

   c. Survivor Income Annuity;

   d. Dependent Life Insurance; and

   e. Supplemental Accidental Death and Dismemberment for the employee and dependents.

If the employees' choices resulted in a credit, they could receive a maximum of $2.00 a week in cash.

Analyzing TRW's plan and rearranging it in terms of core coverage applicable to all employees and entirely paid for by the employer, we find that the core consisted of the existing program of vacation, sick leave, pension and paid holidays, plus:

- Life insurance: 1/2 times salary

- Health insurance: $250 individual and $500 per family deductible per year Hospital care, 80 percent of first $5000 covered expenses and 100 percent of charges in excess of $5,000 per year. No dental.

The optional choices included:

- Life insurance: several levels of options up to a single payment of 1-1/4 times annual salary plus a survivor income annuity 3-3/4 times annual salary, with accidental death and dismemberment insurance 2-1/2 times annual salary.

- Health insurance: the standard plan previously in effect; or better overall coverage.

- Dependent life insurance: $1,500 each

- Supplemental accidental death and dismemberment coverage: 6 plans, each with 3 variations of coverage[5/]

The complete TRW plan is on file in the Office of Program Planning and Development.

When TRW introduced the plan, 80 percent of the employees changed their benefits in some way.

In the period since 1974, TRW has added 4 HMO choices to the Hospital/ Medical coverage options. In 1979, TRW also added an option to buy or sell vacation time.

TRW is currently evaluating its benefits and is looking into the addition of 1) Prepaid Dental, 2) Group Auto, and 3) Financial Planning Services. TRW is also considering expanding the flexible benefits program to other components of its organization.[6/]

1978--American Can

On January 1, 1978, American Can began a pilot program which offerred flexible benefits to 700 salaried employees of its Consumer Tissue and Towel Division. American Can had, from the beginning, worked closely with the Internal Revenue Service so that its plan would be in compliance with ERISA, even before the 1978 Revenue Act changes occurred. On January 1, 1979, the plan was expanded to cover approximately 9,000 salaried employees. American Can plans eventually to extend its flexible program to the thousands of unionized workers if union leaders agree. [7]

American Can's program is "deeply rooted in the company's human resources philosophy--a firm belief in providing an exceptional working environment that emphasizes individual responsibility and achievement. At the same time, cost control and cost efficiencies are key long range objections.[8]

What American Can essentially did is:

- examine its present benefits;
- carve out a core that would provide employees security in five areas: medical, life insurance, vacation, disability income and retirement/capital accumulation; and
- provide flexible credits to choose benefit options in the five areas.

The flexible credits allowed are the estimated dollar difference between the former standardized plan and the core program. Participants in American Can's former standardized benefit program have the opportunity to select coverage designed to be the equivalent of their former coverage. The flexible credits allowed depend on age, service, pay and family status. Additional options can be purchased by employees. Flexible credits not used can be allocated to the corporation's capital accumulation plan.

The core consists of:

Medical: $200 deductible per employee; $400 per family 80% of expenses/year up to $5000; 100% of expenses over $5000; $1 million maximum lifetime benefit per person.

Life Insurance: larger of $20,000 or one times salary, maximum $60,000; travel accident insurance; survivor income; scheduled reduction of insurance after retirement.

Vacation: ranges from 1 week for 6 months to 1 year of service, to 5 weeks for 25 or more years' of service.

Disability: short-term disability full pay up to 6 months; sickness and accident insurance of 70% of annual salary with maximum benefit of $4,083.33 per month; long-term disability maximum annual benefit of $7,500; and service credit toward retirement.

Retirement and Capital Accumulation: 1.4% of highest average salary, minus 1.4% of primary social security, times years of service. Full benefit payable at age 55 with 30 years of service.

Optional benefits choices that may be purchased with flexible credits and payroll deductions consist of:

Medical: One of the following: 90% of first $5,000 after deductible; 100% of first $5000 expenses after deductible; or 100% of first $5000 and $100 individual, $200 family deductible; or medical plan in effect before flexible program. Other options are: vision hearing and preventive health care; dental.

Life Insurance: term insurance of one to four times annual salary: optional survivor income of 20% or 40% of salary; accidental death and dismemberment; 5 times annual salary; life insurance for dependents.

Vacation: one to five additional days

Disability: long term disability covering 50% of salary up to 70,000 or 70% of salary up to $70,000.

Retirement and Capital Accumulation: Flexible credits and payroll deductions of 1% to 10% of annual salary may be made to the capital accumulation fund. American Can contributes 15¢ to 50¢ for each $1 the employee contributes through payroll deductions.

Employees may also purchase American Can stock through payroll deductions. American Can contributes 10¢ to 40¢ for each $1 the employee contributes.

Total payroll deductions toward the capital accumulation fund and stock purchase cannot exceed 10% of annual salary. [9]

A more detailed description of the American Can plan is on file in the Office of Program Planning and Development.

Over 90% of the employees at American Can restructured their benefits when the flexible program was offerred.[10]

A Flexible Plan That Was Not Implemented

Thomas Parfitt, Vice-President of Compensation and Benefits, Harris Trust and Savings Bank of Chicago, shared this experience with us.

Harris Trust has about 4,000 employees. A generous pension plan (70% of high 5 after 35 years) has been in place since the mid-1940's. A profit-sharing plan has been in effect since 1916. The profit-sharing plan provides for deferred income, with 10 to 14% of salary contributed by Harris.

With a good pension plan, Harris considered that deferred profit-sharing was no longer the optimal solution. A flexible benefits strategy was, therefore, developed in 1977. The idea was to allow employees to switch money from profit-sharing to a dental plan.

Employees were surveyed about their desires for a dental plan. There was enthusiastic response. In depth interviews were conducted with 250 employees. Employees were given up-to-date information in the form of special reports and bulletins as planning evolved.

A 60% enrollment was needed to make the dental plan economical to run. Preliminary surveys indicated more than 60% would join. The dental plan was then offerred to employees contingent on 60% participation. Less than 40% actually signed up to enroll. The plan was not implemented.

Parfitt sums up the reasons for failure:

- a hypothetical choice is different from an actual choice involving the employee's own money;
- there was no Harris contribution to make the plan a "better deal"; and
- the plan was too expensive.

As a result of this experiment, Harris still has profit-sharing, with employee withdrawals permitted in line with applicable laws. Employees' morale was raised by the experiment; they apparently appreciated the opportunity for a choice, even if it didn't work out. Management still hopes for a future incremental flexible benefits program to meet changing employee needs. The next steps may be to institute some dental provisions as part of a multi-tiered medical plan with several options. 11/

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DESIGN

From the experience of ETS, TRW and American Can, two basic designs for cafeteria compensation plans emerge. In each of the basic designs there is a core.

The core consists of basic pay plus those benefits which management decides every worker must have. Vacation, sick leave and paid holidays are core benefits. Corporate management may also decide that it would reflect badly on the corporate image if workers died with no life insurance, or had no long term disability provisions, pensions or basic health insurance; these items would then be put into the core.

The core concept is also designed to alleviate management's concern over the consequences of what employees select for themselves. The items in the core are a top level management decision. Not only does the core reflect a very basic corporate image--it also is a financial decision as to what benefits the corporation will continue to completely fund even if benefits costs continue to rise.

At present, all flexible programs have a core. Although it is theoretically possible to have a flexible compensation program without a core, it will probably be many years from now before that happens. Some two-worker families may be an example of employees one of whom would opt to take everything in benefits. Flexible plan designers and corporations are presently not at that point.

One way to design a flexible program is to keep the current benefits package as a core and add flexible choices. The flexible choices can be new benefits or a combination of benefit enhancements over the benefits in the core.

A second way to design a flexible program is to rearrange the benefits package into a core plus flexible options. Design the program so that current employees can be allowed to buy back the same benefits they had before by using their flexible credits. Design options that are more than previous coverage and options that are less than previous coverage in each possible benefit area. New options can also be added if they are desired by employees and are known actuarial risks.

A third way to design a flexible program is to start afresh. We have not seen cases like this; however, it must be counted as a possibility.

The elements of the flexible program and the monies to be spent on it are top management decisions for precisely the same reasons as for the core benefits.

In the design of flexible program, teamwork is essential. The team should have expertise in the following occupational areas: compensation, legal, actuarial and public relations. 7/, 10/, 12/

STEPS IN DESIGN THROUGH IMPLEMENTATION

The major steps we have identified in the design, test and implementation process of setting up a flexible compensation program are listed below.

1. Brief top management on intent to explore a flexible compensation program, startup costs, design alternatives, and obtain support for the venture.

2. Obtain top management decision on expenditure limitations, e.g., same as present, present plus x %.

3. Design core coverage, including alternatives.

4. Obtain top management agreement on core.

5. Develop a timetable for action; plan to work closely with IRS throughout the remaining steps.

6. Design possibilities flexible package(s).

7. Obtain top management support to get input from employees

8. Assemble team having skills in compensation, computer, legal, actuarial, underwriting, administration, communications, and interpreting the Internal Revenue Code.

9. Develop materials to communicate with employees.

10. Train team.

11. Assemble small employee groups, selected at random, to identify perceived employee needs.

12. Design next flexible package based on employee input, insurer's pricing of options.

13. Design computer data base and software systems to process flexible benefits choices.

14. Develop procedures for test of employees' flexible choices.

15. Administer test.

16. Process results by computer system.

17. Assess questionable choices.

18. Assess adverse risks chosen.

19. Design final flexible package.

20. Secure management approval for implementation.

21. Announce implementation.

22. Train employees.

23. Send form to employees to make choices.

24. Process forms, including computer checks for accuracy and logic.

25. Send verification form to employee for recheck and signature.

26. Begin implementation.[2/], [10/], [12/], [13/]

COMMON PROBLEMS AND SOLUTIONS/ISSUES TO BE FACED

Cafeteria compensation plans are exciting and attractive. There are, however, many issues that must be faced squarely before any decision is made to move in the direction of a cafeteria plan.

First of all, there are types of organizations for which flexible programs are probably inappropriate at present. These include organizations in which:

- employee/employer trust does not exist; in this situation employees would be suspicious that the real plot was to take away their benefits;
- computer support is inadequate;
- present benefits are so small that there is too little or no room for any flexibility; or
- highly unionized workforces are driven by other concerns.12/

A major issue to be faced is that top management must completely support flexible plans both by public statements and its commitment of the substantial resources needed for start-up. There is about a 2-year period required to educate employees, develop the plan and computer programs, do pilot studies and negotiate rate structures with insurance carriers. Flexible programs are not instant money-savers. The potential payoffs are in employee satisfaction and cost-effectiveness over the long haul.

Paine reports that: "Another possible objective can be sought by companies that operate in various industries with different patterns of benefits and costs. A flexible program permits the organization to maintain the same core throughout all industries, to maintain either the same or different options, and to make available numbers of flexible credits which are specifically tailored to be competitive in costs in each industry." 10/

Paine also speculates that: "Another goal may be to break the lockstep between union negotiations and salaried plan changes. In many companies, the employer waits until the completion of negotiations with unionized hourly workers before changing salaried benefits. Flexibility provides a structure so different from the hourly program that the company can take what actions it wishes for salaried people without regard to the form and timing of benefit changes for unionized employees." 10/

Sometimes, too, top management truly believes that employees are unable to choose what is best for them. The evidence so far is, however, quite the contrary. This evidence comes from places where communications have been good. The benefits program itself has to have features that can be communicated clearly so that employees can understand the options they have. Computer checks can also be built in to query what seem to be unreasonable choices.

A second issue to be faced is that current tax laws place some restrictions on the combinations of options that can be offered. Careful design is therefore, necessary to either avoid offering taxable options or to make sure that employees know the tax consequences of certain options.

A third issue is the risk of adverse selection. By this we mean the chance that the people who are bad risks will surely opt for coverage of their particular situation while the good risks will avoid coverage they don't think they need and drive up the costs of life and disability insurance and health benefits. Vision care and maternity benefits are common examples of possible adverse selections. A combination of ways to mitigate against adverse selection are available. These include:

- charging costs directly related to the individual employee's risk (e.g., life insurance related to age and evidence of insurability);
- putting several options together to make them more attractive to a larger group and reduce the cost (e.g., combining vision and hearing care);
- including adverse selection items in the core (e.g., maternity benefits);
- making a deliberate decision to subsidize an option in which the initial risk of adverse selection may be high (e.g., dental care);
- designing the program so that employees who do not opt in initially have to wait two years for another chance; and two words
- guarding against costly switches to adverse selection items by restricting some choices to switch every 2 or 3 years.

There is some limited evidence that employees are persistent in their choices. Once they have chosen what they want to buy, they do not change the next year. For example, in dental care, once employees have their mouths in healthy shape, they are likely on maintenance, which costs less, but they are persistent in opting for dental care.[12]

WHY COMPANIES ARE INTERESTED IN CAFETERIA COMPENSATION

What advantages do employers see in cafeteria compensation plans? Generally, the motivational responses of employers fall into two broad categories. Cafeteria compensation (as opposed to a standardized benefit package):

- enables employees to make choices that meet their own individual needs; and

- can be more cost-effective for the employer.

Meeting employee needs. No matter how generous and well-designed a benefits package is, it cannot approach meeting the needs of every individual employee. For example, young employees with several dependents may perceive the need for a large amount of life insurance for themselves and extensive medical coverage for themselves and their dependents. Older employees whose children have grown and left home may prefer to have the bulk of their benefits invested where it can enhance the value of their retirement. A healthy single worker with no dependents may need only minimum life insurance and health benefits and want the remainder of benefits in a savings plan, and or more vacation time. A cafeteria compensation plan can provide enough choices for such employees to meet their individual needs. The experience to date indicates that when employees are given an opportunity to tailor plans to meet their individual needs, most make changes in their coverages.[10]

In addition to the attractive image of an employer who wants to have employee needs met, doing so offers several other advantages. Worker satisfaction is increased. It also makes the workers aware of the dollar value the employer is spending on their total compensation. Workers enjoy freedom of choice and the fact that their management thinks they are able to exercise that choise in a responsible manner. This can lead to worker perceptions that this is a good place to work. This kind of perception can, in turn, produce an atmosphere condusive to productivity.

Thomas Paine, a nationally recognized expert in flexible plans, points out that experience gathered from testing employee preferences clearly indicates that employee satisfaction is not directly correlated with the level of company expenditures. Satisfaction is more likely created if employees have a greater understanding of their benefits, if they know how much the company is spending on them, and if they have some choice in allocating company money to fulfill their individual needs. Paine states that, "There is also some evidence that the act of involvement itself helps to create employee satisfaction."[10]

Cost effectiveness. Well-designed flexible plans maximize the value of employer expenditures on benefits. It is more cost-effective for the employer to spend the same amount of money on employee benefits that individual workers feel can meet their needs than to waste corporate dollars on some benefit features that many people in the workforce do not want.[1/]

The employer which has a generous standardized employer-paid benefits program may find its costs getting out of control in the near future. Inflation has been forcing benefits costs upward. Reducing benefits is seldom an acceptable labor/management alternative. Declining levels of Social Security salary and wage replacement may soon put more demands on the adequacy of the income from employers' pension plans.

Flexible benefit programs offer at least a partial answer to cost-containment. This is because the employer is only obligated to pay any increased costs associated with the core benefits, i.e., those management makes a conscious decision that must apply to every employee for purposes of the corporate image. The employer has the option as to whether or not to increase the monies allocated to the flexible choices and by what amount. Flexible programs also allow the employer to offer employees more benefits choices than the corporation alone can pay; this is done by the employees' paying some or all of the cost of the benefits they desire. The group purchasing power is usually an advantage.

There is some hint of evidence that flexible benefits may help in containing health costs. The Washington Post, on January 6, 1980, reported on an interview with Richard Wibbelsman, Director of Salaried Benefits and Human Resources, at American Can. The Post stated:

> "Medical costs represent the key area in which flexible-benefits plans offer long-term savings. Medical coverage has become increasingly expensive in relation to other benefits, Wibbelsman noted. But by pricing extra coverage so that employers share in those increases, the company expects that workers will opt for relatively less in company-paid medical coverage and buy more of those benefits that are less inflation prone."

It may be possible that flexible plans, which show employees the true costs of what they and their employer are spending on health benefits, will motivate employees to increase their deductible levels, spend their flexible credits on other items, and be more conscious of the necessity for medical costs they incur because the first $100 or $200 come out of their own pockets.

The 60's and early 70's, corporations were in an expansion mentality. Business growth--and resulting salaries and benefits growth were assumed. 1974 marked a mild recession--the first since the 1950's. It was in 1974 that the first operational flexible compensation programs emerged.

Remembering that flexible compensation programs are conceived as a more cost-effective way for a company to spend the same amount of money on employee benefits, the timing is interesting. Since 1974, there has been increasing emphasis in the economy on cost effectiveness and productivity. It seems reasonable to speculate that these factors, along with increased awareness of the differing needs of individual workers and the favorable experience by the pioneers, are the driving reasons behind the new flares of corporate interest in implementing flexible compensation in the early 80's.

CONCLUSION

Cafeteria compensation/flexible benefits/flexible compensation is an idea that has excited and fascinated compensation people for many years. Few companies implemented cafeteria compensation in the 1970's because of the very hard work involved and because IRS insisted that if both taxable and nontaxable benefits were offered, an employee would be taxed even if he or she selected only nontaxable benefits. When the Congress passed ERISA in 1974, it decided to freeze any future cafeteria compensation plans to allow for Congressional study of the tax treatment. The Revenue Act of 1978 provided that employees are subject to tax only on the taxable benefits they select. This is a major breakthrough for compensation planning in the 1980's. The tax issue is settled. The hard work remains ahead.

Advocates of cafeteria compensation point out that it permits individual employees to meet their specific needs and makes employees more aware of the value of their total compensation when they are involved in picking their own coverage. Advocates say that cafeteria compensation is cost-effective over the long haul and that flexibility may be a way to slow down the growth of employer expenditures for benefits and increase productivity in the future. There are about two dozen corporations now contemplating moving toward cafeteria compensation.12/ The 1980's may hold a healthy future for cafeteria compensation plans. In view of the multi-billion dollar annual cost of Federal civilian pay and benefits, cafeteria compensation has worthy outcomes that could be pursued by OPM in the early 1980's.

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