Inflation Is on the Rise–What About Salaries?

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FULL TEXT

Escalating inflation has employers and compensation managers puzzling over their compensation strategies. Cost of living, cost of labor, minimum wage, living wage, recruitment, retention, compression—they're swirling around in our heads like uninvited confetti!

The annual inflation rate for the United States was 8.5% for the 12 months ended March 2022, according to the U.S. Labor Department's Bureau of Labor Statistics. In fact, inflation is at its highest level since 1981. Just think: Well *over half the workforce* has never seen price increases and shrinking dollar values like we're seeing today!

How should employers respond? How *are* employers responding? Before going there, let's discuss two important economic measures that should influence how employers respond to the fluid salary market: cost of living and cost of labor.

These two measures have unique purposes and shouldn't be conflated. Many people assume when the cost of living goes up, the cost of labor must go up at the same rate. But because the cost of living and cost of labor depend on different variables, the rate of change is not necessarily equal.

To demonstrate, if you live in Memphis and earn a salary of $75,000, the equivalent salary in San Francisco would be $102,149, or 36.2% higher than your Memphis earnings. Sounds good, right? But before you pack your bags, you need to know the cost of living in San Francisco is *125.8%* higher than the cost of living in Memphis!

The *cost of living* is the cost required to maintain a certain standard of living in a certain geographic area. Large metro areas like San Francisco have a greater demand for housing, for example, which greatly impacts the cost of living.

The *cost of labor* refers to the sum of all wages paid and is easily influenced by changing business conditions. Examples might include a large manufacturing plant shuts down or a certain skill set becomes highly marketable. Either one can greatly influence the cost of labor in a certain market.

What Employers Are Doing

In its *2022 Salary Guide, National Trends*, Robert Half reports that 96% of employers are offering raises this year. The types of raises reported from high to low are:

While 18% say they are raising salaries to account for inflation, the top three types of raises are not related to inflation, per se, perhaps reflecting an understanding of the difference between cost of labor and cost of living.

Similarly, in a survey titled Cost of Living Adjustment Salary Reportby Salary.com that was conducted from late February to early March 2022, 73% of employers have budgeted payroll increases equal to 4% or higher for 2022. Likewise, 43% reported merit-increase budgets of 5% or more. For comparison purposes, think about this: WorldatWork maintains a year-to-year Salary Budget Increase Trends table. The last time salary budget increases were above 4% was in 2001!

In response to the tight labor market, employers (44.1%) are adjusting their salary structures, according to the Salary.com survey. Other employers (50.1%) reported adjusting salary levels for specific jobs to be more competitive.

While annual salary reviews are typically considered a sound practice, some employers are reviewing salaries more often to ensure their pay remains competitive. The industry and availability of labor in specific geographic regions

are factors that influence the frequency with which the market should be assessed.
Employers are becoming more creative with variable pay and employee benefits. Providing onetime bonuses puts money in employees' pockets but doesn't add a recurring cost increase to the company's salary budget.
As an alternative to increasing base pay, some employers are looking to enrich their 401(k) plans, according to a report titled "Inflation Continues to Surge, Affecting Wage and Benefits Planning" by Stephen Miller, CEBS, for the Society for Human Resource Management (SHRM). Miller reports large organizations, such as KPMG and Facebook parent Meta, are changing their 401(k) contributions to be more generous, and 16% of large and midsize companies plan to increase their 401(k) contributions or reinstate a contribution match this year.

What *Not* to Do

Amid the turmoil of unprecedented workplace disruption and economic uncertainty, it's easy to forget your core compensation principles and strategy. Remember the difference between cost of living versus cost of labor. Don't automatically throw money at your workforce because the consumer price index (CPI) goes up. Do some homework to figure out what is happening in your labor market, and respond accordingly.
Hopefully, you have a well-designed compensation philosophy in place. If you don't have one, write one. Your company's philosophy about pay should be a compass that guides pay decision-making, helping you respond appropriately to changing market conditions.

What *You* Can Do

Times of crisis call for decisive and often atypical responses, not frenetic reactions. How your organization responds to the current job and salary market is unique. As an HR professional, you may exert some influence by educating the room about cost of living versus cost of labor, reminding leadership of your company's compensation principles and philosophy and doing your due diligence to develop recommended solutions to meet your company's distinctive needs.

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