The Elementary Microeconomics Of Private Employee Benefits

By Dan M. Bechter

Employee benefit plans have achieved significant success and growth, as documented in several recent studies.[1] The number of workers and dependents covered by such plans has grown dramatically over the years, as have the types and amounts of benefits provided to the average worker. Employee benefits now account for a sizable share of compensation, challenging direct wages and salaries in importance in some types of employment. Paying wages in kind, rather than in money, is a trend with no apparent end.

What explains the rising popularity of employee benefits? How does this trend affect the economy through its impact on wage structure and labor mobility? This article explores these and related questions, following a review of developments in employee benefit plans.

EMPLOYEE BENEFITS OVER THE YEARS

Nonmonetary payment is obviously nothing new; barter has a longer history than does money. But, by the time the American economy had evolved to its industrialized state of 50 years ago, money wages had relegated wages in kind to fringe importance in most occupations. The major exception was in agriculture, where the employing farmer often provided his hired hands with board and room (a practice that prevails today).

In 1948, the Chamber of Commerce of the United States surveyed a cross section of American industry in order to estimate the "nonwage" labor costs of doing business in 1947. Among the findings:

> **Wages paid for time worked understate the direct labor costs of doing business by a significant amount. There has been a tremendous growth in the importance of nonwage labor costs in the past twenty years. The average nonwage payments of the companies in the national survey represent an addition to the labor costs of doing business equal to 15.4 per cent of the total wage bill.**[2]

In its latest report on employee benefits, published some 26 years after the first in the series, the national Chamber calculates that benefit payments add to labor costs by an average of 37.5 per cent of wages paid for time worked in the companies it surveyed. About 14.6 percentage points of this is part of payroll in the form of wages paid for time off (paid vacations, holidays, rest periods); the remaining 22.9 percentage points is outside of payroll in the form of employer contributions for social insurance, company benefit plans, and miscellaneous employee benefits. This nonpayroll category is one-sixth of total ***compen-***

1/For example, see *Employee Benefits*, 1973 (Chamber of Commerce of the United States, 1974); Mitchell Meyer and Harland Fox, *Profile of Employee Benefits* (The Conference Board, 1974); and Walter W. Kolodrubetz, "Employee Benefit Plans, 1972," *Social Security Bulletin*. May 1974, pp, 15-21.

2/*The Hidden Payroll* (Washington: Chamber of Commerce of the United States, 1949). p. 5.

Table 1
EMPLOYEE COMPENSATION BY TYPE, 1929-73
(Per Cent of Total)

Type of Compensation	Companies Surveyed				Estimates-U.S.A.		
	221 in 1947	742 in 1973	The Same 155: 1953	The Same 155: 1973	1929	1953	1973
Total Compensation	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Payroll	92.4	83.3	89.1	82.2	98.7	93.0	86.7
Pay for time at work	88.3	75.7	82.6	72.9	98.0	87.7	79.3
Working time	86.7	72.8	80.8	70.2	97.0	85.6	76.2
Paid rest periods, lunch periods, etc.	1.6	2.9	1.8	2.7	1.0	2.1	3.1
Pay for time not at work — vacations, civic and personal leave, sick leave, etc.	4.1	7.7	6.6	9.3	0.7	5.3	7.4
Nonpayroll Employer Expenditures	7.6	16.7	10.9	17.8	1.3	7.0	13.3
Legally required social insurance	2.8	6.3	2.5	5.5	0.8	3.0	7.0
Private pension, health plans, life insurance, death benefits, severance pay, discounts on goods and services purchased from the company, etc.	3.9	8.7	6.6	10.7	0.4	3.0	5.5
Other items: profit sharing, special bonuses, thrift plan contributions, tuition refunds, etc.	1.0	1.7	1.8	1.6	0.1	1.0	0.9
Employee benefits by one definition: Total compensation minus paid working time	13.3	27.2	19.2	29.8	3.0	14.4	23.8

SOURCE: Chamber of Commerce of the United States.

sation, a more comprehensive measure of true wages that includes nonpayroll benefits as well as payroll (Table 1).[3]

The national Chamber's estimates of employee benefit payments in the country as a whole in 1973 closely agree with those calculated from compensation statistics for the private nonfarm economy in 1972, reported by the U.S. Bureau of Labor Statistics (Table 2). Most of the discrepancy between the two bottom-line percentages is due to the inclusion of coffee breaks, etc., in the larger figure. Were it available, the 1972 percentage for the economy as a whole would be somewhat less than for the private nonfarm economy, since this category excludes government (Federal, state, and local) employment, where supplements to wages and salaries are estimated to be slightly less than average, and agricultural employment, where such benefits are estimated to be substantially less than average.

Both tables show how benefits have grown as a percentage of compensation, indicating that benefits have been increasing faster than wages and salaries. While most types of benefits have grown in absolute terms along with wages and salaries, growth in relative importance is concentrated largely in paid leave time, and in employer contributions for legally required social insurance and for voluntary employee benefit plans.

According to a study by the Conference Board, "time off with pay has increased for all classes

3/*Employee Benefits, 1973*, p. 26.

Table 2
EMPLOYEE COMPENSATION BY TYPE, 1966 and 1972
(Per Cent of Total)

Type of Compensation	Private Nonfarm Industries 1966	1972
Total Compensation	100.0	100.0
Payroll	88.8	86.8
Pay for time at work	83.0	80.5
Straight-time pay	80.6	78.5
Premium pay (overtime, weekend, holiday work, and shift differentials)	2.4	2.0
Pay for time not at work (vacations, holidays, civic and personal leave, sick leave, etc.)	5.8	6.3
Nonpayroll Employer Expenditures	11.2	13.2
Legally required social insurance	5.2	5.5
Private retirement and health benefit programs (except sick leave), severance pay, supplemental unemployment benefit funds	4.7	6.5
Nonproduction bonuses, savings and thrift plans	1.3	1.2
Employee benefits by another definition: Total compensation minus pay for time at work	17.0	19.5

SOURCE: Employee Compensation in the Private Nonfarm Economy, 1972, Bureau of Labor Statistics.

of employees." The major current trends identified are (1) increases in the number of paid holidays, (2) increases in the length of paid vacations for long-service employees, (3) decreases in service requirements for vacations of given lengths, including more liberal vacations for new employees, (4) declining differences in paid vacations between office workers and plant workers, (5) increases in time off for civic duties and personal business, and (6) increases in the proportion of companies with paid, noninsured sick leave (but no increase in the duration of noninsured sick pay benefits).[4]

Employer contributions for social insurance have grown tremendously in the past generation (Table 3). Government employee retirement systems have increased rapidly, paralleling the trend in the private sector. But the largest and most rapidly growing component has been social security (OASDHI). This country's system of social insurance has been much in the news of late, and is worthy of careful study. Employer contributions for social security are part of labor compensation, and the revenues do provide benefits for Americans. But the character of these benefits differs somewhat from private employee benefits, and they will not be considered further here.

Employer contributions to private employee benefit plans more than tripled between 1963 and 1973, growing to $39.2 billion at an average annual rate of 12.4 per cent. By coincidence, this rate of growth exactly matched the average annual rate of increase of employer contributions to social insurance over that same decade, during which time wages and salaries grew at an 8.3 per cent average annual rate.[5]

The types of coverage under privately underwritten employee benefit plans differ widely. For example, in 1972, an estimated 70 per cent of all wage and salary workers were covered by hospitalization plans written in compliance with the law, but fewer than one-third were covered by plans paying major medical expenses. Less than half of wage and salary workers in private industry have retirement benefit plan coverage, and only 14 per cent are covered by long-term disability benefits.[6] Of course, many workers without insurance coverage from their employers do have coverage obtained elsewhere. In the case of retirement plans, length-of-service requirements tend to hold down the percentage of all workers covered.

Private pension plans, including deferred profit sharing, account for nearly half of all employer contributions to private benefit plans. The Conference Board survey indicates that the proportion of companies with pension plans is increasing. Trends toward provisions for earlier retirement with more liberalized benefits are noted. Benefits under some plans are still unrelated to earnings, but the trend would appear to be toward the more common type of formula that in-

4/*Profile*, pp. 37, 85-103.

5/*Surve of Current Business*, U.S. Department of Commerce. July Issues, gable 1.10.
6/Kolodrubetz, p. 16.

Table 3
EMPLOYER CONTRIBUTIONS FOR SOCIAL INSURANCE
1940, 1967, and 1973
Millions of Dollars (Per Cent of Total)

Contribution Item	1940		1967		1973	
Total Contribution	$1,624	(100.0)	$21,869	(100.0)	$48,407	(100.0)
Federal old-age, survivors, disability, and hospital insurance	329	(20.3)	13,373	(61.1)	30,703	(63.4)
State and local employee retirement systems	155	(9.5)	3,320	(15.2)	6,946	(14.3)
Unemployment funds	978	(60.2)	3,396	(15.5)	6,733	(13.9)
Federal civilian employee retirement system	93	(5.7)	1,361	(6.2)	3,212	(6.6)
Railroad retirement insurance	67	(4.1)	399	(1.8)	758	(1.6)
Cash sickness compensation	—		12	(0.1)	46	(0.1)
Veterans life insurance	2	(0.1)	8	(0.0)	9	(0.0)

SOURCE: U.S. Department of Commerce.

cludes final average salary in its computation. The years-of-service requirements for qualifying for pension coverage (vesting of benefits) have been eased in many plans, and will soon be revised in many more in order to comply with new laws.'

The other half of employer contributions to employee benefit plans goes almost completely for insurance of one kind or another. In the health insurance category, the trend is toward more complete coverage of expenses, including new coverages such as dental care, outpatient medical and psychiatric care, and home nursing care. Long-term disability insurance has spread rapidly in the past few years, with a trend toward a reduction in service requirements for disability pensions, and an increase in benefit levels. Group life insurance continues to be the most common employee benefit plan, providing a benefit typically equal to twice salary. Rapidly gaining favor as a death benefit is the spouse's pension, which provides for income maintenance in the event the employee dies before retirement.

A relatively small share of total employer contributions to employee benefit plans provides for severance pay, supplementary unemployment benefits, and for supplements to employee savings in company thrift plans. This small share is partly due to the relatively low cost of termination pay allowances compared to health and pension plan expenses, and to the small percentages of companies which have savings plans or provide private supplementary unemployment insurance. But for particular employees, these benefits can be a large percentage of compensation.[8]

THE ECONOMICS OF EMPLOYEE BENEFITS

A worker's compensation obviously involves two parties: the employee and the employer. But each such employment contract both reflects competitive forces and becomes a factor in the determination of labor market conditions. Thus, competition for workers tends to drive up money wages in companies that do not provide employee benefits. The payment of compensation in kind (in the form of goods and services) also affects others elsewhere in the economy. It has an economic impact on those who produce and sell employee benefit packages (e.g., insurance companies), and on those whose businesses are stimulated by employee benefit payments (hospitals, vacation spots, etc.). Pension fund accumulations play an important role in capital markets. Everyone is affected in some way if the nature and growth of employee benefits have consequences for income distribution and resource allocation in the economy as a whole. Although these equity and efficiency implications of employee benefits are not fully explored here, their directions can be indicated by economic analysis of the employer

7/*Profile*, pp. 47-64.

8/*Ibid*, pp. 1-9.

and employee reasons for wanting benefit plans, and of the resolution of these forces in the labor market.

The Employer

"Behavior in one's own self-interest" is the fundamental axiom of microeconomic analysis. In the theory of the firm, a business is assumed to utilize factors of production in such a way as to minimize the costs of operating at any particular level of output. This rule of thumb—applied to personnel policies—can be refined to take account of the fact that people are very special factors of production. Thus, assuming the employer tries to hire and perpetuate a labor force that gets the job done at minimum cost, how do employee benefits help the employer achieve this objective?[9]

Company payments for employee benefits may hold down labor costs in several ways. Compensation partly in benefit form may help promote the idea of the company family, thereby increasing productivity through greater employee loyalty and dedication (less absenteeism and turnover, more cooperation, etc.). Such benefits as "company subsidized" parking and eating facilities may help control work time better than if employees are forced to satisfy such needs on their own. The design of some employee benefits, such as vacation time and retirement credits, acts to reduce turnover because of the tie to seniority, or length of company service. The design of others can help increase turnover where and when it may be desired, as in pension plans with provisions for early retirement.

The employer also can design benefits to attract certain *types* of employees. For example, a dairy farmer who needs two full-time employees plus some readily available occasional labor can attract applications from couples with families by offering a large home and free milk as part compensation. In industrial situations, benefit packages can be made to appeal relatively more to younger or to older workers, to married or to single workers, to men or to women, and so forth. This is not to say that the benefits would be discriminatory in a legal sense, but only to observe that certain benefits may be valued more highly by certain groups.

Employers do not have to pay employment taxes on compensation paid in benefits. This is undoubtedly a primary reason for the growth of employee benefits as a form of compensation, discussed more fully in a subsequent section on government influence. Finally, employee benefits can be the least costly method for employers to reward employees by rank or experience, or to hide the true compensation levels of certain employees from other employees, or from stockholders, regulatory bodies, or taxpayers.

The Employee

The principle of self-interest is assumed to guide the employee, too. Naturally, a worker wants to sell his services for as much compensation as possible, subject to the usual qualification of "other things equal" ("working conditions" is a convenient catch-all for many of these other things). Compensation includes, of course, the value that the worker places on benefits provided by the employer. Such payments in kind, therefore, are earned just as surely as are money wages. The Conference Board study observes that:

> **A second major pattern concerns the employee's pocketbook. The 1963 to 1973 decade has clearly shown that employee benefits are looked upon as earned compensation and, as such, the employee should not be required to pay any portion of the cost of these plans.**[10]

This statement is somewhat misleading, however, in implying that employees are better off if employers pay the cost of benefits. Tax considerations aside, this is not the case. Actually, employee benefits are earned compensation only to the extent that the employer *does* pay for them. It is important to remember that an employee earns a particular level of total compensation,

9/Bevars Mabry, "The Economics of Fringe Benefits," *Industrial Relations*, Vol. 12, No. 1, February 1973, pp. 95-106.

10/*Profile*, p. 3

so that the more of compensation paid in the form of benefits, the less the employee receives in money wages. Thus, even if the employee were required to pay the entire cost of his benefits, his money wages would need to be that much higher. After deductions for these benefits, his remaining money wages would be just the same as if he were not required to pay any portion of the cost. Since the bookkeeping makes little difference in the usual case of benefits which cover all employees, the trend toward noncontributory benefits is explained best by the tax advantages of this alternative—advantages perceived by both employee and employer.

The idea that employees earn all of their compensation is not based on some philosophical notion, but on the economics of competitive markets. Employers, who want to minimize costs, compete with one another for employees, who sell their services for as much as they can get. This interaction of supply and demand results in a market price of labor, or level of compensation, for any particular type of worker. If compensation levels are market-determined, it follows that the greater are employee benefits, the lower are money wages.

Would an employee be better off with the option of receiving all of his compensation in money wages, assuming no tax advantages of benefit payments? If one accepts the premise that each individual should be allowed to make his own choices, the answer is yes. A neat proof in the theory of consumer preference shows that a worker is at least as well off with the money, since he can still buy those benefits that he wants, or something else that he prefers.[11] Yet, while some of the growth in employee benefits as a share of compensation can be attributed to employer paternalism, much of the thrust behind this trend has come from employees, often through their unions.

Professor Mabry believes that union leaders like employee benefits:

(a) The administration of such programs requires a bureaucracy which tends to strengthen the rationale of union existence, membership dependency, and, hence, organizational survival.

(b) Fringe benefits are much less visible than [money] wages, and as such, are less likely to undermine the power of the union by attracting a large number of job applicants. Also, the lower visibility of benefits permits uniform money wages among firms within an industry, thereby lessening intra-union rivalry while still allowing unequal compensation levels.[12]

Employee compensation is higher with benefits, he adds, because the supply of labor is less than it would be if all compensation were in the more visible money wage form, because of group purchasing power (lower premiums) of insurance, and because of favorable tax treatment of benefits. Each of these alleged advantages to workers are scrutinized following a look at government influence on employee benefits.

The Government

A principal conclusion of the recent study of employee benefits by The Conference Board may be summarized this way:

> The. . .pattern that clearly emerges from the Profile study is that government intervention in the employee benefit packages offered by private sector employers has increased, rather than decreased, over time. Not only has the government's role increased, but it has changed its basic orientation from regulator to social planner.
>
> Regardless of which trends are followed by unions and corporate benefit staffs in the next ten years, the government is now almost certain to become a major, if not the dominant, force in the design of employee benefit packages during that time.[13]

In support of this conclusion, researchers Meyer and Fox give ample evidence including official

11/See, for example, Richard A. Leftwich, *The Price System and Resource Allocation* (5th ed.; Hinsdale, Ill.: The Dryden Press, 1973), pp. 92-94.

12/Closely follows Mabry, pp. 97-98.

13/*Profile*, p. 5.

designation of four Mondays as holidays, legislation affecting pension and health insurance provisions, and Internal Revenue Code regulations determining just what benefits qualify for special tax treatment.

The power to tax is power enough by itself to permit centralized social planning. By taxing various forms of compensation unequally, the government can encourage the development of certain types of employee earnings (benefits) at the expense of money wages. Tax inducements (and discouragements) work indirectly through the market system to bring about change, but their effects are just as certain as those from direct legislation. For example, a tax code that subsidizes compensation paid in the form of health insurance premiums leads to the widespread adoption of such plans by employers. Eventually, most American workers become covered by health insurance whether they want it or not. This is not to attack the idea of social planning aimed at universal coverage against losses of income due to death, illness, unemployment, etc. Rather, the intent here is to point out that it is an illusion to believe that the growth of privately underwritten employee benefit plans is completely the result of free choice in a free enterprise economy.

The strength of the Internal Revenue Service in shaping benefit packages is exemplified by the failure of the "cafeteria" concept of employee benefits to catch on. Under a cafeteria benefits system, an employee is allowed to choose from an assortment of compensation alternatives, including money, of equal cost to the employer.[14] This type of package is rare, because the government refuses to grant favorable tax treatment to certain options.[15]

It is clear that government intervention in compensation practices is largely responsible for the rapid growth of employee benefits. It can be argued that this growth is a desirable objective. However, not all of the economic consequences of government intervention in this area are summarized by the declining share of money wages in compensation. Moreover, not all of the tax advantages that employers and employees believe they get from benefits materialize once the labor market and the economy adjust to the changes that are introduced by such compensation schemes.

The Labor Market and the Economy

The individual employer-employee analysis is inadequate for determining the effects of employee benefits on the economy. The conclusions from such "partial equilibrium" analysis are not, in general, extendable to aggregations of business firms, workers, etc. Tracing the impact of an outside shock, such as tax subsidies for employee benefits, through the economy can be tedious, but a compact two-sector model of the labor market can explain some of the most important consequences.

Suppose that competitive economic conditions characterize the labor market, and that employers are divided into two groups: those who pay part of compensation in "free" benefits, and those who do not. Assume first that there are no employer or employee advantages to compensation paid in benefit form. Assume also that all workers want the goods and services (insurance, etc.) represented by the benefits, in at least the amounts provided, but that these also may be purchased on the free market. As indicated earlier, the result is straightforward: the equilibrium levels of compensation will be exactly the same for both types of employer, with the non-benefit group paying money wages higher by the value of the benefits. (Any difference in compensation levels between the two employer groups would be a disequilibrium. The higher level of compensation would attract more workers than needed; the lower, fewer workers, ultimately bringing about equality.)

Under this first set of assumptions, the economy is unaffected if some employers pay part of

14/See, for example, George W. Hettenhouse, "Cost/benefit analysis of executive compensation," Harvard Business Review, July-August 1970, pp. 114-24; also Donald H. Mehlig, "Compensation Planning--Cafeteria Style," Pension and Welfare News, April 1973, pp. 53-58.
15/*Profile*, pp. 2-3.

compensation in benefits.[16] Because the employees of the benefit-providing institutions would have bought the benefits on the free market anyway (by assumption), they lose nothing. But they do not gain anything either. This conclusion of no economic impact holds even if employees differ in their preferences for benefit-type goods and services, so long as there are enough workers who want benefits to fill all jobs providing benefits (or, put another way, so long as there are at least as many jobs without benefits as there are workers who do not want benefits). Free choice is then accomplished partly by choosing one's employer.

Why would any employer choose to provide employee benefits under these assumptions? Clearly, with tax advantages assumed away, the administrative cost of a benefits program would have to be offset by savings elsewhere, or the practice would soon die out. If net costs were lower because of benefit plans (due perhaps to productivity gains arising from a "we're all in this together" spirit), the practice would spread to other firms on employer initiative. At some point, however, as more and more employers adopted employee benefit programs, the supply of workers preferring such benefits to other goods and services might dry up. Beyond that point, benefit-providing employers would have to increase money wages to attract additional labor. This would increase their labor costs, of course. Therefore, benefit programs would continue to spread to other employers only until an equilibrium was reached. In this equilibrium, individual employers would gain nothing from having benefit plans. What about employees and the economy? This is difficult to answer. On the one hand, if employee benefit plans really increase productivity, then average real wages would be higher. On the other hand, some of this increase in real wages would be in forms (benefits) not preferred by all employees.

Impetus for employers to provide employee benefits may come from the employees, even without supposed tax or insurance premium advantages. Workers may want the employer to look after their interests. A company program spares the individual the problems of choosing an insurance company, a proper program, and the extent of his coverage. It also relieves him of the trouble and worry associated with accumulating funds to meet periodic premiums on due dates, and of the need to process papers to establish his eligibility." In other words, employee benefit plans save the worker time and effort. How does this factor influence the labor market under the competitive conditions assumed?

If the employee wants the service, it is reasonable to believe that he pays for it, and this is what happens in the absence of any employer advantages from providing such plans. This outcome results in lower apparent total compensation in firms with benefits, because workers are willing to work for less. for such employers.[18] This would mean that money wages would not only be less (than in the no-benefit situation) by the value of the benefits, but also less by an additional amount equal to the value employees place on the service of administering these benefits. (This latter value may be greater than the cost of benefit administration, in which case the employer makes a "profit" on its employee benefits program!) To the extent that benefits plans are the result of such decisions, the economy is not adversely affected, and free choice is preserved.

Another advantage claimed for employee benefit plans is savings through group purchase of insurance. To be sure, premiums per participant are lower in group plans. But competition in the labor market erases this savings for employees, in the following manner. Start with the supposedly true situation that workers really do "save

16/Except for those effects arising from the *administration* of benefits by employers.

17/Richard A. Lester, "Benefits as a Preferred Form of Compensation," *Southern Economic Journal,* Vol. 33, No. 4, April 1967, p. 490.

18/Total compensation really remains the same, since the service of providing benefits is a benefit itself.

money" in such plans. If that is the case, then compensation levels are higher in employment where benefit plans are provided. But, this is clearly a disequilibrium; employees and job applicants will desert the lower-compensation, non-benefit employers, and offer their services to benefit-providing employers. This has the market effect of depressing money wages in benefit employment, and increasing them in non-benefit employment. An equilibrium is reached only when the savings' advantage to benefit employment has disappeared.

Now, remove the assumption of no tax advantages to employee benefit plans. In the real world, there quite clearly are such tax advantages.[19] First, assume the tax advantage is to the employee only. Does he really end up ahead with a compensation package partly in the form of tax-free benefits? He does not in the case of a perfectly competitive labor market. This is obviously analogous to the situation described previously. Any tax savings from benefits are perceived by labor, and the wage structure adjusts to a new equilibrium that eliminates any such advantage. The employee's total compensation with tax-free benefits remains the same as without them.

Suppose all companies pay their employees partly with tax-free benefits. Are workers better off then? Are their real, after-tax incomes higher? No, workers are not better off if production remains the same and the government spends as much as before. The same amount of taxes must still be collected; unless this tax burden is shifted somehow to the owners of capital, lower taxation of benefits-type compensation must be made up by higher taxation of money wages.

Even though an employee's total compensation may be unaffected by benefit plans, the employer's labor costs may be reduced by the government's subsidization (through favorable tax treatment) of certain types of compensation in kind. This will certainly encourage the adoption of employee benefit plans, as firms not enjoying the subsidy are at a competitive disadvantage with those subsidized. In the adjustment phase, the effect is to shift the tax burden from businesses with benefit plans to those without them. As before, the tax revenues must come from somewhere. When "tax-free" benefits become nearly universal, the competitive advantage is gone: employers are no better off in the new equilibrium. Employees, it can be argued, are worse off since their choices have been reduced.

Suppose that it really is true that companies with benefit programs compensate their workers better (pay more) than those without such plans. This would imply imperfections in the labor market (such as barriers to entry) and a consequent misallocation of resources. In particular, the benefit-plan firms would be employing too little labor because their compensation level was held artificially high. Total output would be less because of these losses in efficiency. Since real wages are tied to production, this would mean lower average levels of real compensation in the economy.

The labor market is, in fact, replete with imperfections. Does this detract significantly from the conclusions of the preceding analysis, which is based primarily on equilibrium comparisons in perfectly competitive markets? It does not detract from the principal conclusion that employee benefit programs do not increase total compensation in the economy. Indeed, to the extent that employee benefits introduce additional imperfections, total employment and compensation are probably decreased. While interference in imperfect markets can improve resource allocation, this hardly seems to be the case for employee benefits, many of which reduce mobility and disguise levels of compensation. The existence and persistence of imperfections in the labor market do require a softening, however, of the conclusion that employees receiving bene-

19/See, for example, Thomas I. O'Regan, Jr., "501(c)(9)—Paying the Tax Collector," *Pension and Welfare News*, June 1973, pp. 46-48. Some of the tax advantage to employees is in the form of shifting tax burdens over time. This is particularly true of private pension plans. Taxes are not paid for contributions, but are paid when benefits are received during retirement. They are then generally taxed at lower marginal rates.

fits cannot realize a net gain in compensation. They can, but only at the expense of those not receiving benefits, so long as imperfections shield the favored group from free market forces.

SUMMARY

Benefit plans account for a large and increasing share of employee compensation. Legally required employer contributions for social insurance have grown rapidly in the past decade and the growth of private employee benefit plans has been equally rapid. To some extent, company benefits programs have come about as a result of free market, free choice interactions among employees and employers. Much of the increase in paid leisure time, for example, surely reflects the desire of employees to be paid partly with time rather than money. But to a large extent, the government's subsidization of benefit plans explains their popularity in compensation packages.

Economic analysis of the market consequences of paying wages in kind rather than in money reveals that levels of total compensation are unaffected by this practice if competitive conditions prevail. That is, workers enjoy no net savings from the tax free character of certain benefits, or from the lower premiums under group insurance. Tax advantages enjoyed by employers with benefit plans are tax disadvantages to those without such plans, which ultimately leads to widespread coverage by employers, and no remaining advantage to anyone. Employee benefit plans can only increase the compensation levels of particular groups of workers by interfering with competitive forces, and this translates into a loss to the economy as a whole, since resources will not be allocated efficiently.