

Fringe Benefits and Input Substitution

Government regulations often have unintended consequences. For instance, current federal tax law requires that firms provide fringe benefits in such a way as not to discriminate against lower-income workers. Presumably, the purpose of this regulation is to ensure that low-income workers will have access to health care, pension benefits, and other fringe benefits. Unfortunately, this policy often limits the employment opportunities of low-income workers.

To see why, consider a company that hires computer programmers and secretaries. Suppose the annual wage bill of a computer programmer is \$30,000 and that of a secretary is \$15,000. The company is considering offering a family health care plan worth \$3,600 annually to its employees. Ignoring the fringe-benefit bill, the relative price of a secretary to a computer programmer is $\$15,000/\$30,000 = .5$. But when the cost of the health care plan is added in, the relative price of a secretary increases to a little over .55 of that of a computer programmer. Isoquant and isocost analysis suggests that

firms should substitute away from the now higher-priced secretaries to minimize costs.

Seem far-fetched? Recently economists Frank Scott, Mark Berger, and Dan Black examined the relationship between health care costs and employment of low-wage workers. They found that industries that offered more generous health care plans employed significantly fewer bookkeepers, keypunch operators, receptionists, secretaries, clerk-typists, janitors, and food service workers than did industries with lower health care costs. Moreover, industries with higher levels of fringe benefits hired more part-time workers than did industries with lower fringe-benefit levels since the government does not require firms to offer pension, health care, and many other fringe benefits to part-time workers.

Source: Frank Scott, Mark Berger, and Dan Black, "Effects of Fringe Benefits on Labor Market Segmentation," *Industrial and Labor Relations Review* 42 (January 1989), pp. 216–29.