

“Pricing Health Care: The Folly of Buying Health Care at the Company Store”

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*Wall Street Journal*, 3 February 1993

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Toward the end of World War II, I served as an instructor in a quality-control course for Navy procurement officers. It was held in Hershey, Pa. As I recall, we stayed at the Hershey Hotel, on the corner of Cocoa Avenue and Chocolate Boulevard, across the street from the Hershey Junior College, where the actual instruction took place, a block or so from the Hershey Department Store, and so on. You get the idea. The stench – or perfume – of paternalism was heavy in the air.

Early in the century such company towns, most far less benevolently paternalistic than Hershey, were common. Workers who were employed at mines or factories located far from large cities, in towns that typically had only a single major employer, were often required, or induced, to live in company housing and buy their food and other supplies at company stores. In effect, they were paid in kind rather than in cash – the so-called truck system. As Merle Travis put it in his song, made popular by Tennessee Ernie Ford: “You load 16 tons and what do you get?/ You get another day older and deeper in debt./Saint Peter, don’t you call me, ‘cause I can’t go,/I owe my soul to the company store.”

Reformers objected strongly to the practice, maintaining that workers should be paid in cash and be free to spend their incomes where they wanted. As the country grew and the isolated company town became far less common, reformers had their way and the payment of wages in cash became the norm. By the 1940s, Hershey was an isolated relic.

Not so today. The company town has been revived in one major area: medical care. It is taken for granted that workers should receive their pay partly in kind, in the form of medical care provided by the employer. How come? Why single out medical care? Surely food is no less essential to life than medical care. Why is it not at least as logical for workers to be required to buy their food at the company store as to be required to buy their medical care at the company store?

The revival of the company store has less to do with logic than with pure chance. It is a wonderful example of how one bad government policy leads to another.

During World War II, the government imposed wage and price controls, while at the same time financing wartime spending by printing money. The resulting inflationary pressure, along with price controls, produced shortages of all kinds, including labor. Firms competing to acquire labor at government-controlled wages started to offer medical care as a fringe benefit. That benefit proved particularly attractive to workers and spread rapidly.

Initially, employers did not report the value of the fringe benefit to the Internal Revenue Service as part of their workers’ wages. It took some time before the IRS realized what was going on. When it did, it issued regulations requiring employers to include the value of medical care as part of reported employees’ wages. By this time, workers had become accustomed to the tax

exemption of that particular fringe benefit and made a big fuss. Congress responded by legislating that medical care provided by employers should be tax-exempt.

Wage and price controls ended but the tax-exemption of medical care provided by employers did not, which explains the survival of the company store in this area. That survival is unquestionably a major reason for the present crisis in medical care.

The obvious solution is to eliminate the tax exemption of medical care, in which case employers and employees would find it mutually advantageous to convert the fringe benefit to a cash wage supplement. However, this solution is widely regarded as not politically feasible.

An alternative often proposed is to continue the tax exemption but end the requirement that medical care be purchased through the company store. Let employers now providing medical care and their employees agree on a specified sum to be added to cash wages in lieu of employer-provided medical care. Let that sum be tax-exempt to the employee if deposited in a so-called medi-save account. Let employees have complete discretion over how they use that sum, provided they use it for medical care. If they do not use all of it, let it accumulate and under specified conditions be withdrawn by the employee for other purposes.

I have little doubt that the introduction of such medi-save accounts would significantly reduce the total cost of medical care. (A recent book by John Goodman and Gerald Musgrave, *Patient Power*, published by the Cato Institute, offers a thorough account of this proposal.) Employees who now have no incentive to economize on medical care, or to shop for the providers that best meet their needs economically, would be given an incentive to do so.

I hasten to add that this proposal is not a panacea for present difficulties. Medicare and Medicaid would still remain powerful impediments to the efficient and effective use of medical facilities and personnel.

10/10/12