

## Employer mandates and health insurance reform

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## Introduction

- Tax code encourages firms to provide health insurance to workers
  - Health insurance is paid for in pre-tax dollars, get more for your money
- Therefore, employers are the primary source of health insurance for the non-elderly, non-indigent
- Also the primary reason for such a high uninsurance rate

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- Many reform proposals are centered around expanding insurance through employers
- Short primer on some health care reform
- Then examine some of the labor market implications

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## Clinton health care reform

- Large scale effort to reform health care
- Blew up current system started from scratch
  - Focus on expanding access/controlling costs through government type insurance plans
- Complicated system that was would have been foreign to most
- The proposal was crushed by its own weight – falls apart in 1994

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## What have we been doing the past 13 years?

- Two major efforts aimed at coverage
  - Medicare Part D
  - SCHIP program
- Movement to managed care
- BUT....Most of the 'action' has been with states
  - unsuccessful but informative

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## Small Group Reform

- People without EPHI or small firms must purchase insurance in the 'Small Group' Market
- Small groups tend to have
  - Higher prices
  - Higher administrative fees
  - Prices that are volatile

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- **Prices are a function of the demographics**
- **Concern: prices for some groups too high**
- **Lower prices for some by "community rating"**
- **Nearly all states have adopted some version of small group reform in 1990s**

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## What happened?

- Increased the price for low risk customers
  - Healthy 30 year old pays \$180/month in PA
  - \$420/month in NJ with community ratings
- Low risks promptly left the market
- Which raised prices
- Policy did everything wrong

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## Lesson

- Idea was correct:
  - Use low risk to subsidize the high risk
- But you cannot allow the low risk to exit the market

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## Massachusetts Reform

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## MA Reform: Romney

- Most ambitious state reform to date
- Many features but.....
- Two that generate the most heat:
  - Individual mandate, required by law to carry insurance
  - Firm Mandates – must provide insurance or fined \$295

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## MA Reform

- If you require insurance, you need to make it affordable
- State subsidizes purchases for poor
- Firms must establish Section 125 plans
- Established the “Connector”

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## Connector

- Merge of individual and small group market
- Market maker in insurance
- Community rating
- Requirements on what plans must have

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## Connector

- Individual plans cost about \$200/month
- 40-60% lower than average plan
- Was achieved primarily by higher cost sharing

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## Exporting MA Plan?

- Plan is being studied extensively by
  - Other states
  - Presidential candidates
- MA is very unique so it might not travel
  - Low uninsurance rate (9%)
  - Unique fiscal situation that was used to finance the law

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## Other reform plans

- Edwards, Obama, and Clinton have offered detailed plans
- All loosely based on the MA reform
- Maintain EPHI as basis of system
- Try to lower costs to those without EPHI so they can afford insurance
- Plans vary in detail but contain many similarities

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## Democratic plans

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Edwards	Obama	Clinton
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## Pay or Play

- Firms must pay 5% wage bill to health insurance or pay that as a fine
- Proposed in 26 states in 2006
- Language -- firms must pay 'their fair share'
- Problem: ignores the realities of the labor market

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## Will firms pay or play?

- In March 2007, Private industry
  - Average hourly comp. \$27.61
  - Wages/salaries \$18.34 (71%)
  - Health insurance \$ 1.83 (7.1%)
- Wal-Mart pays 5-7%
  - 40% workers covered by insurance provided by Wal-Mart

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- Insurance is one component of a compensation package
- Increased costs in one area will be paid for by reducing on costs in another (wages)
- In long run, costs will be borne by workers

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## Second type of employer mandate

- 1800 different state mandates to cover particular products/services
- Wide variety of services
- Without law, your insurance provider may already provide

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## Service (# of states)

- In vitro fertiliz. (13)
- Mental health parity (45)
- Port wine stain elimination (2)
- Hospice care (11)
- Drug abuse treatment (34)
- Hair prostheses (9)
- Alcoholism treat (45)
- Anti-psychotic drugs (2)
- Prostate cancer screening (32)
- TMJ disorders (20)
- Domestic partners (8)
- Adopted children (43)

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## Reminder about employer mandates

- ERISA Federal law that outlines treatment of employee benefits
- If a firm self-insures, federal law (ERISA) applies
- If they purchase insurance plans for their employees in an open market, state laws apply
- State mandates do not apply to employees whose firms self insure

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## This section

- Discuss likely impacts of government mandates on the labor market
- Outline the distortions that might be caused by mandates.
- When they might generate less distortion than other options like government provision of the good/service

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## Tradeoffs

- The government sometimes mandates employers provide a particular benefit
- Sometimes the government taxes the firm and then provides the benefit to all
- When is one more preferred than another? Do we get less distortions from one program than another?

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## Current context

- Should the government
  - Mandate firms provide health insurance
    - Tie the benefit to employment
    - only benefit those that work
  - Should it tax current workers and provide the benefit directly to all
- Similar but distinct distortions in both cases

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## Examples

- Many examples of government mandates
  - firms required to provide some benefit to workers – a benefit tied to employment
- Three key examples
  - Unemployment insurance
  - Workers compensation
  - Social security

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## Example: Unemployment insurance

- All states required to pay for unemployment insurance (UI) for workers
- Workers receive UI if they are fired/laid off
- Do not receive benefits if they quit
- Premium is a function of
  - Earnings
  - benefit level
  - firm's previous history of job turnover

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- Premiums are collected from firms
- Benefits are provided by state UI programs
- Program taxes firms, then provides workers with a benefit

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### Raise taxes to pay for some Government-provided benefit

- Suppose that the govt. will provide some benefit TO ALL – not just to workers
- Benefit is not contingent on employment
- The funds for this program must come from somewhere
- For simplicity, lets assume it will come from a payroll tax collected from firms
  - Fixed costs per hour of employment
  - Increase in the hourly costs of labor

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### What might that tax be?

- Example: cost of health insurance
- Average workers works 2000 hours/year
  - 50 weeks, 40 hours/week
- Assume health insurance costs \$5000/person per year
- Roughly \$2.5/hour of work

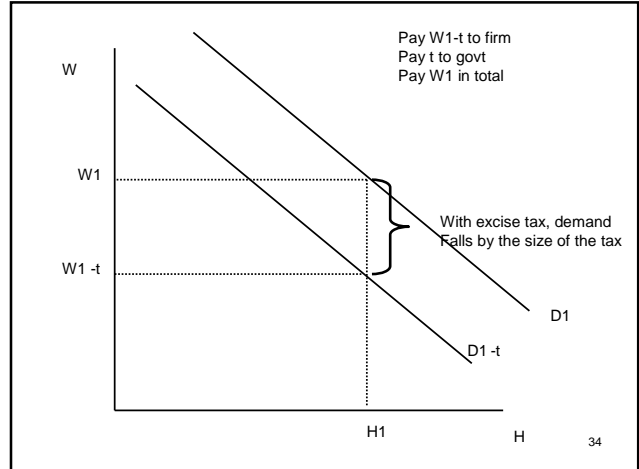
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- D1 is the original demand for labor before the payroll tax
  - At  $W_1$  firms willing to hire  $H_1$  hours
- Remember, Y axis is the wage transacted between firms and employees
- Impose a payroll tax of  $\$t/\text{hour}$
- For every hours hired
  - Firms pays wage to worker
  - Additional  $\$t$  to government

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- Under the payroll, how much are firms willing to hire?
- To hire  $H_1$  hours, wage must fall to  $W_1 - t$ 
  - Firms is only willing to pay a total of  $W_1$  per hour if it hires  $H_1$  workers
  - Firms pays  $W_1 - t$  to workers
  - Addition  $t$  to the govt.
  - Total of  $W_1$
- Payroll tax shifts down the demand for labor by amount equal to the tax

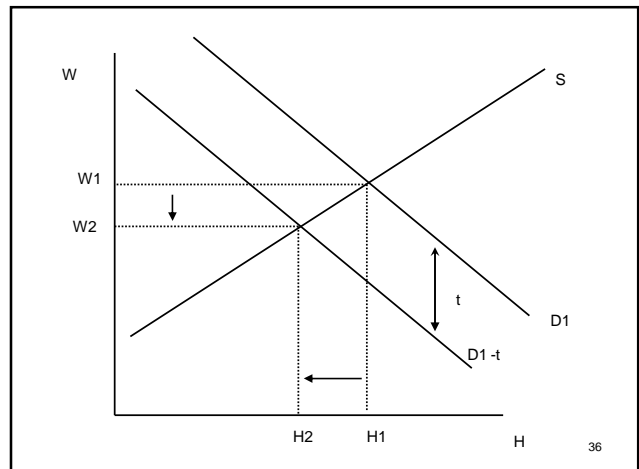
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- Market equilibrium before tax
  - $W_1, H_1$
- Payroll tax shifts down the demand for labor by an amount equal to the tax
- Market clearing wage falls to  $W_2$ , employment falls to  $H_2$
- The payroll tax to fund health insurance has distorted the labor market

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## Tax incidence – who pays for the tax?

- Notice two things
  - Wage received by workers has fallen from  $W_1$  to  $W_2$ . Workers are paying for the coverage in the form of lower wages
  - Wage paid by the firm has increased
    - Wage transacted between firm/worker fallen from  $W_1$  to  $W_2$
    - Total compensation is  $W_2 + t$ , so, cost has increased from  $W_1$  to  $W_2 + t$

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- Old friend dead weight loss has appeared again
- Because labor demand had declined, consumer's surplus has shrunk
  - Old CS = Area above line  $W_1d$  and below demand
  - New CS = Area above line  $W_2a$  and below demand

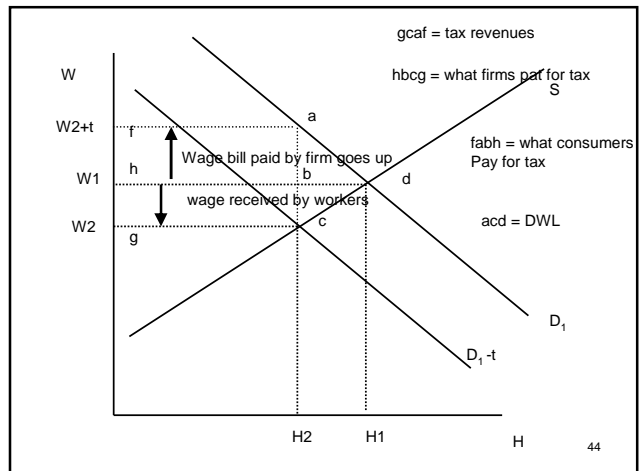
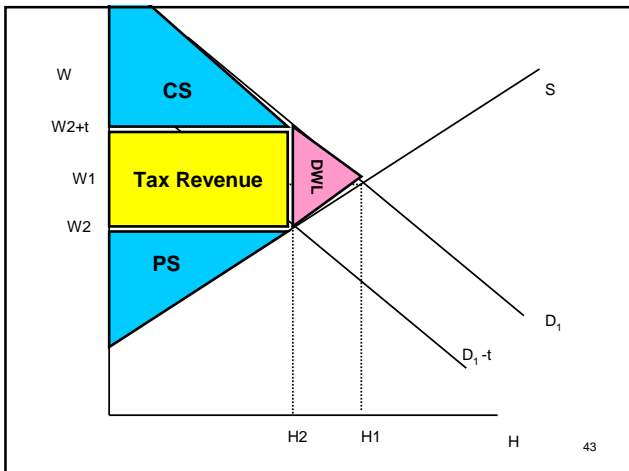
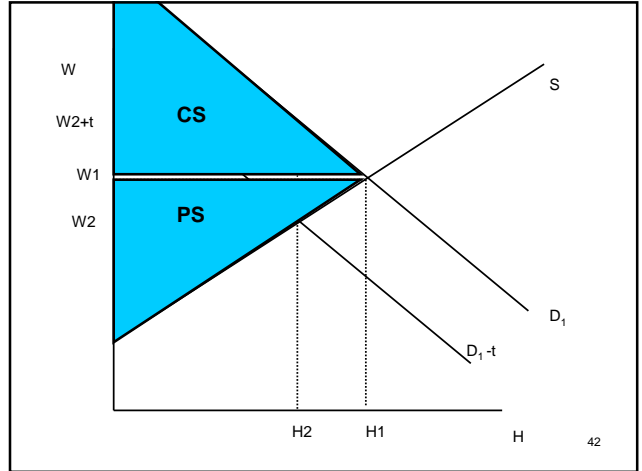
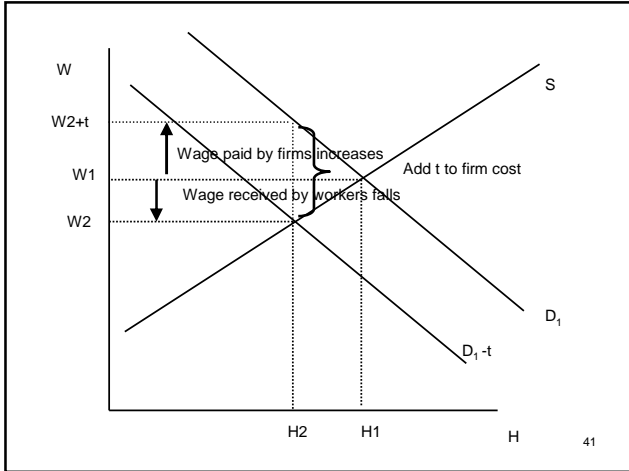
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- Because supply has fallen, there is a change in producers surplus
  - Old PS = area below line  $W_1d$  and above supply
  - New PS = area below  $W_2C$  and above supply
- Total surplus has fallen by
  - Area  $facdg$

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- Some of that area is captured by the government in the form of taxes
- $H_2(t)$  = area  $(facg)$
- Firms pay area  $(fabh)$
- Workers pay area  $(hbcg)$
- An area is lost  $(adg)$  -- dead weight loss of taxation

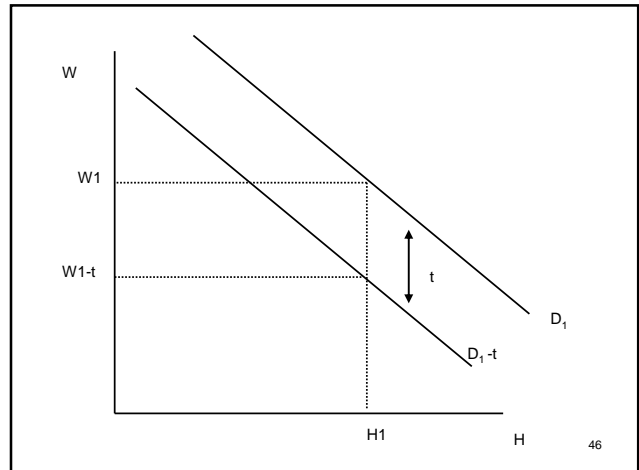
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## Employer mandate

- Employers must provide health insurance to workers
- Suppose that the cost of the program is  $\$t$  per hour to the firm
- The mandate has the same impact as a per unit payroll tax
  - To hire  $H_1$  hours, firm is willing to pay  $W_1$
  - With a tax, the only way they would hire  $H_1$  is if wages fell to  $W_1-t$

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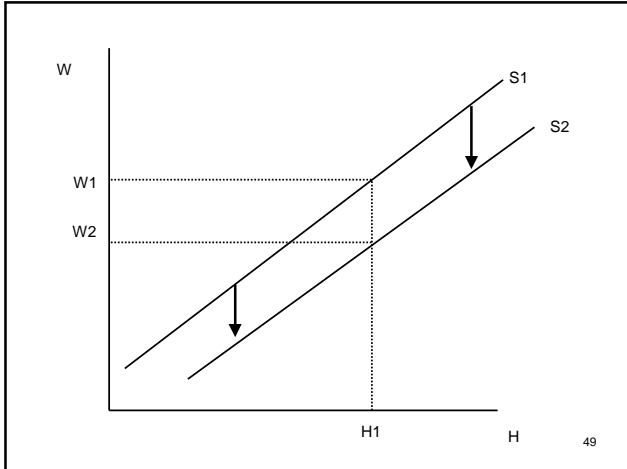
## What about labor supply?

- Height of supply curve represents what people would supply to labor market at prevailing wage
- Position of labor supply curve is a function of job attributes
  - When the job 'improves', people willing to supply more at any prevailing wage
  - As quality of job declines, they supply less

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- Original supply curve is  $S_1$ 
  - At wage  $W_1$ , workers willing to supply  $H_1$
- With employer mandate, firms now provide health insurance
- Workers value the insurance, so at any hours, they are willing to take less in wages for the same job
- supply curve shifts to the right

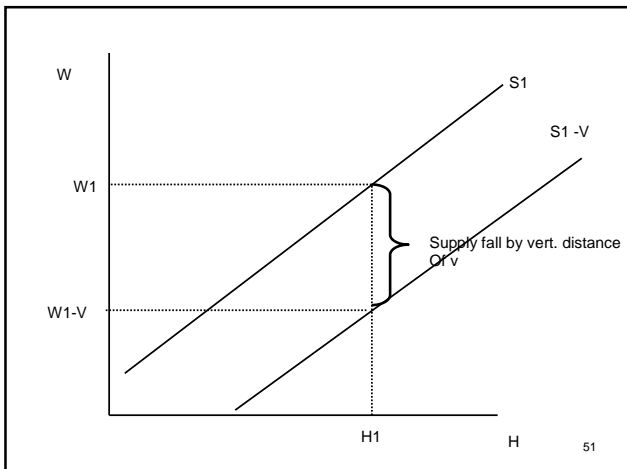
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## Put some more structure

- Monetize the benefits that workers place on the new mandate
- Workers value at an amount equal to  $\$V$  per hour
- Supply curve shifts down by an amount just equal to the value
  - Before mandate: willing to supply  $H1$  at  $W1$
  - After: willing to supply  $H1$  at  $W1-V$ 
    - Receive  $W1-v$  from job
    - Receive  $V$  from new mandated benefit or  $W1$  in total

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## Three cases

- Case 1:  $V=0$ 
  - workers do not value mandate at all
- Case 2:  $V < T$ 
  - Workers value the mandate less than they pay in taxes
- Case 3:  $V=T$ 
  - Workers value the mandate at what it costs them in taxes

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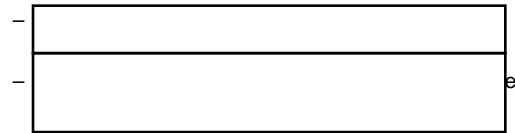
## What we are going to do

- Consider what is more efficient: govt mandate firms provide or govt tax and then provide
- E1 is initial equilibrium
- E2 is equilibrium under govt tax/provision
- E3 is equilibrium under employer mandate

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## Case 1

- Labor demand



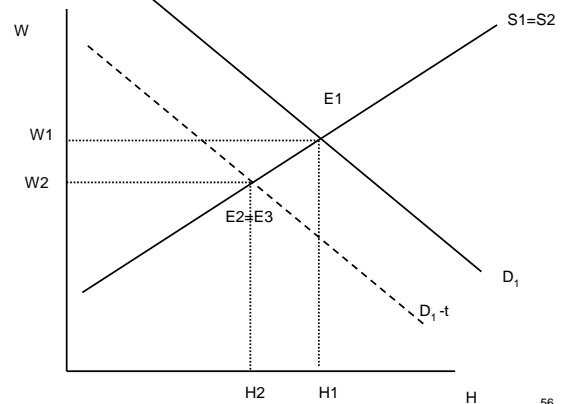
- Labor supply:



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- What would be the equilibrium if the govt taxed firms and directly provided the benefit?
- Would be the same – firm has an increased cost of employment, labor supply stays the same
- In this case, govt mandate and govt provision is the same

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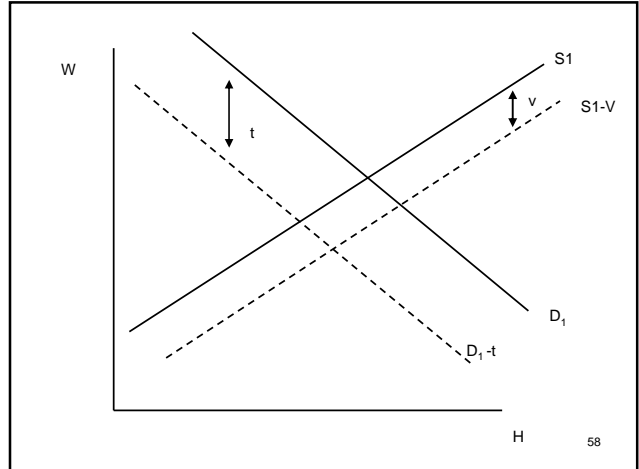


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### Case 2: $V < t$

- Demand curve falls by  $t$
- Supply curve falls by  $v$

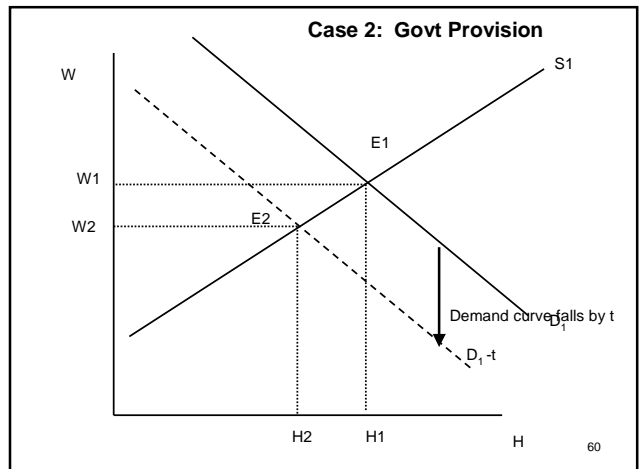
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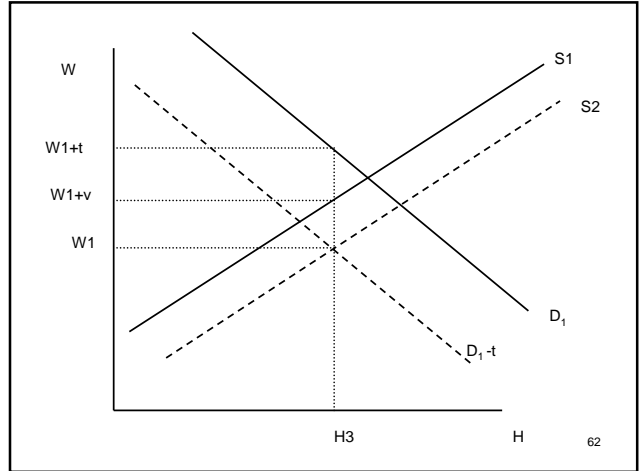
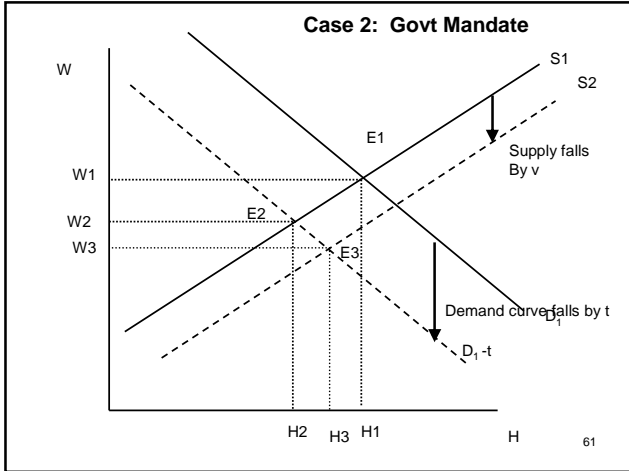
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- Without mandates, Equilibrium  $E_1$ .  $H_1$  hours, workers required  $W_1$  in wage.
- With mandates, equilibrium  $E_3$ . Quality of the job improves, so supply curve falls, new hours/wages are  $H_3/W_3$
- What is the equilibrium if the govt taxes and provides the benefits directly?  $E_2$
- Govt mandates look superior in this case

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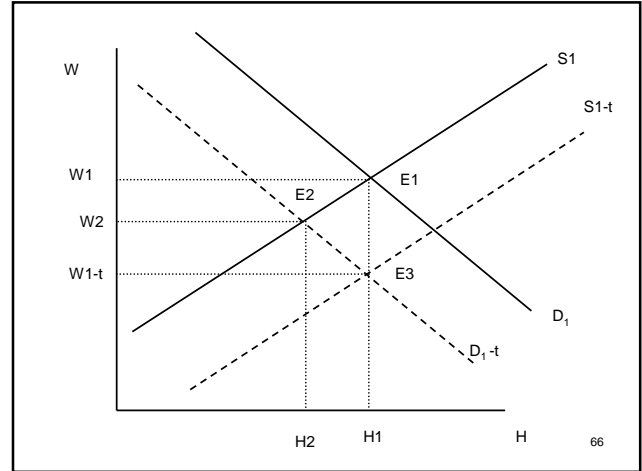
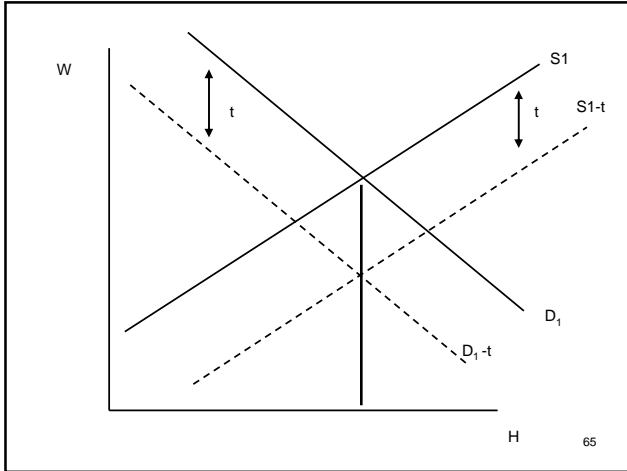


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- Case 2: Govt mandate**
- Workers
    - Get hourly wage of  $W1$
    - Receive benefit of  $v$
    - Get job worth  $W1+v$  per hour
  - Firms
    - Pay hourly wage of  $W1$
    - Pay tax of  $t$  per hour
    - Have hourly costs of  $W1+t$
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- Case 3:  $V=t$**
- Demand curve shifts down by  $t$
  - Supply curve shifts down by  $v$
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- Workers
    - Receive  $W_1-t$  in an hourly wage
    - Receive  $t$  in benefits
    - Receive  $W_1-t+t = W_1$  in hourly benefits
  - Firms
    - Pay  $W_1-t$  in hourly wage
    - Pay  $t$  in benefits
    - Pay  $W_1$  in total compensation per hour
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- ### When workers value the benefit
- Mandates are superior to govt tax/provision
  - Why: when tie benefits to the job, the labor market distortions of govt tax/provision are reduced/eliminated because of a supply response
  - Key result: if workers value benefits – they pay for the mandated benefits in the form of lower wages --
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## Example

- Supply:  $W_s = 40 + (1/3)L$
- Demand:  $W_d = 190 - (2/3)L$
- $W$  is daily wage,  $L$  is number of workers willing to work a full day
- Market equilibrium:
  - $W_s = W_d$
  - $40 + (1/3)L = 190 - (2/3)L$
  - $150 = L$
  - $W = 40 + (1/3)(150) = 90$

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- Case 1: Suppose a mandate increases costs by \$30/day. Workers do not value the benefit. What is the market outcome?
- Demand for workers will fall by a vertical distance of the tax or \$30
- Nothing will happen to supply
- $W_d - t = 190 - (2/3)L - 30 = 160 - (2/3)L$
- $W_d - t = W_s$

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- $160 - (2/3)L = 40 + (1/3)L$
- $L = 120$ ,
- $W_s = 40 + (1/3)L = 50 + (1/3)120 = 80$
- $L$  has fallen by 30 units
- Wage received by workers has fallen by \$10 (from \$90 to \$80)

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- Cost per day for firms hiring workers has increased by \$20
  - Old wage is \$90
  - New cost is \$80 wage + \$30 = \$110 cost per day in benefits

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### Case 3

- Suppose workers value the benefit at \$30/day ( $V=30$ )
- Labor supply curve will shift down by an amount equal to the benefit
- $W_d - t$  is still  $160 - (2/3)L$
- Supply is now  $W_s - v = 40 + (1/3)L - \$30$
- $W_s - V = 10 + (1/3)L$

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- New market equilibrium
- $W_d - t = W_s - v$
- $160 - (2/3)L = 10 + (1/3)L$
- $L = 150$
- $W_d = 60$

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- Workers receive a job that is valued at \$90/day
  - \$60 in wages
  - \$30 in benefits
- Firms are paying \$90 per day in employment
  - \$60 in wages
  - \$30 in benefits

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### Gruber

- Prior to 78, few plans covered childbirth
- 1975-79, 23 states passed laws mandating coverage for childbirth
- 1978 Pregnancy Discrim Act, prohibited any differential treatment of pregnancy in employment relationship
- State/Fed law increased cost of health insurance by expanding benefits

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- Research question: who pays for the additional benefit?
- Readily-identifiable beneficiaries:
  - Families w/ worker/spouse in childbearing age
- Easily identifiable group who receive no benefit
  - Single men
  - Older couples past childbearing age

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- Efficiency of group mandates assumes cost shifting via wage
- Some limits
  - Anti-discrim laws
  - Min wage
  - Work practices (unions) that make pay uniform
- If you cannot shift costs, may change incentive to hire the group receiving the benefit

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## Experimental Design

- Difference-in-difference-in-difference
- 1<sup>st</sup> difference
  - Treatment states before and after intervention
  - Treatment group are people likely impacted by the law (married women)
- 2<sup>nd</sup> difference
  - Treatment states before and after intervention
  - Control group are people not likely impacted (single males and older women)

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## Two potential experiments

- Experiment 1
  - Treatment: states that adopted laws
  - Control: those that did nothing
- Experiment 2:
  - Treatment: Federal law
  - Control: states that had a statute in place

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- Data: May CPS – used to identify insurance status (Now is done in March)
- Problem: Prior to 1978, not all states identified – some in state groups
- Three large states with laws: IL, NJ, NY
- All other states from same region that can be identified prior to 1978 are in control

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- Controls:
  - IL (OH and IN)
  - NY and NJ (MA, CT and NC)

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TABLE 1—THE COST OF ADDING MATERNITY BENEFITS TO A HEALTH INSURANCE PACKAGE

Coverage	Demographic group	Annual cost (1990 dollars)	Annual cost (1978 dollars)	Cost as percentage of 1978 weekly earnings
Family	20–29-year-old females	\$984	\$360	4.6
Family	30–39-year-old females	\$756	\$277	3.5
Individual	20–29-year-old females	\$324	\$119	1.5
Individual	30–39-year-old females	\$252	\$92	0.9
Family	20–29-year-old males	\$984	\$360	2.9
Family	30–39-year-old males	\$756	\$277	1.7

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### DDD, Mean Log Hourly Wage

		Before	After	$\Delta$
Treatment: Mar.	Reform	1.547	1.513	-0.034
Women 20-40	No ref.	1.369	1,397	0.028
			$\Delta\Delta$	-0.062
Control: older women and single males	Reform	1.759	1.748	-0.011
	No ref.	1.630	1.627	-0.003
			$\Delta\Delta$	-0.008
			$\Delta\Delta\Delta$	-0.054

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- Previous two slides
  - Maternity benefits are 4-5% of weekly wages for married women < 40
  - Wages of this group fell by 5-6%
- What does this imply about efficiency of labor market?

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