Perspective

Who Pays For Employer-Sponsored Health Insurance?

Workers’ and employers’ perceptions about the insurance/wage trade-off strongly influence their reactions to public policy.

by Linda J. Blumberg

The question of who pays for employer-sponsored health insurance has been debated for decades, with economists holding fast to the theory that workers pay through lower wages, and noneconomists by and large responding that employers pay. The answer to this question has substantial policy implications, some of which are alluded to briefly in the paper by Mark Pauly and colleagues in this volume.

Here I discuss what the literature says about the incidence of payments for employer-sponsored health insurance, the gaps that remain in our understanding of this issue, and the implications of these matters for current health policy debates.

The Economic Literature

Because workers who are more highly compensated tend to prefer part of their compensation in health insurance, simple analyses that do not take into account the selection of workers into particular jobs generally will find that health insurance is associated with higher wages. Studies that do take selection effects into account tend to find a negative relationship between wages and employer-sponsored insurance. Including controls for both workers’ and employers’ characteristics seems also to be a key component of successful empirical studies. I briefly review here the published literature that most carefully addresses the complex identification issues involved.

Health insurance and wages. In a study of public school districts, Randall Eberts and Joe Stone found that an additional dollar of health benefits was associated with an eighty-three-cent reduction in teachers’ salaries. In another paper Stephen Woodbury defined fringe benefits in two different ways when exploring substitutions between wages and nonwage benefits: health insurance plus life insurance; and pensions, health insurance, and life insurance. While he found greater substitutability under the second definition, he also found relative ease of substitution between wages and health/life insurance. Jonathan Gruber and Alan Krueger used increases in employers’ costs for workers’ compensation insurance to quantify the costs passed back to workers. Depending upon the group of industries used in their analysis, they found that 56–85 percent of these costs were shifted back through reduced wages.

Insurance mandates and wages. In a different study Gruber used another approach to measure the wage effects of state and federal mandates for the coverage of maternity benefits. Using a small group of states prior to the federal mandates, he found that wage differences between states with and without mandates more than compensated for the costs associated with those benefits. Using all states, he found that 59–90 percent of the cost of the mandates was passed back to workers in the form of reduced wages. The estimate for
full-time workers was 75 percent. He also found that the wages of married women fell more than did those of single women or married men. We do not know the prevalence of maternity benefits prior to mandated coverage. If such benefits were relatively prevalent, one would expect that the mandates would have had only modest effects on wages.

Where economists come out. Economists tend to agree that, based upon both theory and the best empirical evidence, workers bear a large portion of health insurance costs through reduced wages. However, they also agree that little work has been done specifically on job-based health insurance. In addition, there is no compelling evidence on how this actually occurs. For example, individual workers’ wages might be adjusted, or wages might be adjusted on average. Perhaps adjustments are done by specific groups of workers, by the health status of workers and dependents, or by the coverage category (family versus single). There also is no knowledge of how long it takes for such adjustments to occur. The role of labor turnover here is also imperfectly understood, as are the ways in which employers and workers might respond to various reforms. These unanswered questions may be as important for policy purposes as quantifying the long-run effect.

Implications For Public Policy

Tax credits. Workers. Workers’ perceptions of the financing burdens will affect their responses to health system reform. Consider, for example, recent proposals for introducing health insurance tax credits, which Pauly and colleagues discuss. Such tax credits can be structured in a variety of ways. But at their core these proposals consist of a specified dollar amount that is provided if health insurance is purchased. This dollar amount is received as a decrease in tax liability.

Under one scenario, those purchasing insurance in the nongroup market would receive a credit that would approximate the subsidy afforded those enrolling in employer-sponsored plans. Many factors would influence the decision of whether to enter the nongroup market, including workers’ access to insurance policies in that market, premiums and benefits for available policies relative to employer plans, the increased cost to the individual of researching available policies and choosing among them, and the extent to which workers believe that if they disenroll from a job-based plan, they will receive a compensatory increase in wages.

Employers. Economists are fond of saying that employers are neutral with regard to offering health insurance versus increased wages. If employers only care about their total compensation bill, this is probably true. However, in the practical world of business, other factors are likely to affect the decision of whether and how much to pass back the former costs of health insurance in the form of higher wages.

Let us assume that employers desire only to break even on compensation costs. One might expect, then, that they would be willing to pass back the full amount that the worker imposes on them for health insurance expenses if the worker left the plan. There are reasons why this might not happen, however. First, employers do not have to pay their share of payroll taxes on contributions to health insurance, whereas they are required to do so on wages. So an employer would not break even if the full health insurance cost were passed back to the worker; breaking even would require holding back sufficient funds to pay for the increased in taxes.

Second, if a majority of employees in a particular firm preferred to maintain employer-sponsored insurance, the employer might not want to provide incentives for workers to drop out of the risk pool. Workers who are most likely to find the nongroup insurance market attractive are those who are young and have the lowest expected health care costs. If these workers left the employer pool, those who remained would tend to have higher average costs. This would make the remaining group less attractive to an insurer, which would at a minimum increase the aver-
age premium faced by each worker and perhaps make it more difficult to find benefit packages that were attractive to the group. So if the workers who stayed in a group plan were (as would be expected) the older, higher-paid workers in the firm, the employer might try to keep the risk pool intact by not passing the wages back to the healthier workers who were considering exiting the plan.

Third, depending upon the number of workers in the firm, insuring any of them might require insuring nearly the whole group. Particularly for small firms, insurers set a minimum percentage of workers in a firm who must enroll if the insurer is to offer a plan to that firm at all. One way in which employers can attempt to meet such a qualification might be to deny those workers opting to use their tax credit in the nongroup market a compensatory rise in their wages.

Fourth, employers repeatedly say that they do not believe that the costs of health insurance are passed on to workers through reduced wages. Such employers are unlikely to immediately pass back wages to workers who are leaving their employer-sponsored plan. Therefore, there may be virtually no increased wage effect in the short run, but a significant one as the market moves closer to a new equilibrium over time.

All in all, if employers are not inclined to provide increased wages to workers who enter the nongroup market, or if the wage increase is modest relative to the costs of insurance, or if the increases will not come until some undetermined later time, the effects of introducing a tax credit will be quite different than if a full pass-back is to occur. More important, perhaps, than the employer’s actual behavior is workers’ “expectation” of what the employer will do. If workers do not believe that their wages will increase, they will be reluctant to drop their job-based coverage.

**Public coverage expansions.** Another policy that changes the relative attractiveness of employer-based insurance is the expansion of public insurance coverage for low-income persons. A number of researchers have analyzed the extent to which persons with private insurance might opt for public coverage if it were made available to them. Public coverage, such as Medicaid, may be more attractive to workers than employer plans are if the employer requires direct payments from the worker for participation in the plan and the public plan does not require cost sharing, while the employer plan does. Also, the incentive to switch from employer to public coverage would be enhanced if workers were to be compensated with higher wages for doing so. Again, whether the worker believes that this will happen is perhaps even more important than whether the employer actually intends to do so.

Here, in particular, the ways in which the costs of health insurance are distributed across various types of workers have important implications for the magnitude of the incentives. It may be, for example, that low-wage workers do not bear the full incidence of the costs of their health insurance through reduced wages, especially in the case of firms with few low-wage workers. This may be because such workers are paid at or close to the minimum wage and there is little room for passing back the costs of health insurance, while the employer is uncomfortable about or unable to exclude this group from eligibility for coverage. If this were true, employers would not be expected to fully increase wages for these workers if they were to switch from the employer plan to public coverage. Thus, workers’ incentive to make such a move would be reduced.

**Employer mandates.** The distribution of costs and benefits associated with mandated employer-sponsored insurance coverage, such as that proposed in 1993–1994 by the Clinton administration and others, is also profoundly
affected by who bears the burden of such coverage. If individual workers do bear the burden of such coverage, mandating that each employer provide and each employee enroll in such coverage implies that low- and moderate-income workers without such coverage before reform would see significant relative decreases in their wages as a result. Such burdens could be lessened by subsidizing low/moderate-income workers, where such subsidies were progressively financed. However, evaluating the distributional effects of such reforms (who wins and who loses) requires making assumptions about the incidence of the costs of coverage.

Even if we knew the exact magnitude and pattern of the insurance burden falling upon workers under the current system, we still could not necessarily translate that into a precise understanding of how employers might adjust wages under reforms. Considerations apart from maintaining a given level of total compensation will likely enter into such decisions, and the preferences of particular types of workers may carry more weight than those of others in such a process, at least in the short run. And again, at least in the short run, employees’ expectations of employers’ behavior may be more important than employers’ intent, and these two may be quite distinct.

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NOTES
7. R. Kaestner and A. Carroll, “New Estimates of the Labor Market Effects of Workers’ Compensation Insurance,” Southern Economic Journal 63, no. 3 (1997): 635–651. This paper also implies a high degree of substitutability, although the estimates presented are not easily translatable to a precise estimate of the decrease in wages as a function of an increase in costs.