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Employer Insurance under Employer Mandates and Subsidized Exchanges: Time to Dump or Stay?

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Beginning in January 2014, the Affordable Care Act will provide generous health insurance subsidies to millions of lower and middle income households (from 139% to 400% of the federal poverty line), but only if they obtain coverage through a state’s health insurance exchange. At present, however, the majority of these and of all privately insured households get their health insurance in connection with employment. Employers are confused about how to respond: should they drop their group coverage and tell workers to choose one of the plans in the public exchange, or should they continue to offer and manage their own benefits? And policymakers are concerned, since widespread “dumping” would increase the cost to the government of subsidies and erode the “American Way” of providing private health insurance. What makes economic sense for employers, and what are the real sources of uncertainty?

Why might an employer think about dropping employer-paid coverage when subsidized exchanges become available in 2014? The simple arithmetic suggested by some consultants compares the employer penalty (if any) for not offering coverage with current cost to the employer for offering coverage, and draws the conclusion that the employer will save money and increase profits by dropping payment for coverage if the former is less than the latter. Former Governor John Engler, now head of the Business Roundtable, says that “it is absolutely the case” that many businesses will drop coverage, pay the penalty, and save money (Reichard 2012).

The economic reality is much more complex. Ultimately, employer responses should be dictated by how their potential employees value their current health insurance benefits, and by the advantages associated with the non-taxability of employer paid premiums, and not merely by the amount of subsidies and penalties for offerings in exchanges. Accounting for the way in which employees, both with and without health insurance presently, think about wage income compared to benefit “income”—the net value (after tax break) in having employer-provided

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insurance rather than cash wages—can lead to different conclusions from the conventional wisdom of merely following the arithmetic of penalties and subsidies.

Take, for example, the basic calculation of a firm that is told by consultants, “If you can save more from stopping health insurance premium contributions than you will pay in penalties, you should drop coverage.” Under this simple logic, for firms up to 50 workers, dissolving group insurance would then be a no-brainer because there is no penalty. For larger firms facing a penalty (at least for a while) of about $2000 per worker, most will find their current payment for health insurance to be larger than the penalty, so dropping still makes sense.

But this calculation misses something important. If they want to keep their workers, employers will have to offer higher cash wages to offset the cost to the worker of now having to pay the premium for insurance in the exchange. For example, if the total family premium was $12000 but the worker explicitly paid only $3000, from the worker’s viewpoint losing coverage and going to an exchange (without a subsidy) would be like a wage cut of $9000 of after-tax income. That’s assuming the $12000 exchange policy is as attractive as what the HR department had on offer. Even in a soft labor market, it is usually not a smart employer move to chop more than $9000 from wages. But how much you can cut does depend on worker preferences and other job opportunities.

Things are different if the worker would be eligible for a generous subsidy in the exchange Consider one extreme. Based on the Kaiser Family Foundation’s calculator, a family of four with income at 200% of the poverty line (about $47,000) should expect to receive a subsidy for a “silver” policy from an exchange equal to about 75% of the estimated $12000 premium for that policy; this family would have to pay $3000 from after tax income but now the employer could save the $9000. In contrast, if that household received coverage in an employment based group plan and in return sacrificed an equivalent amount of cash compensation or paid part of the premium via a cafeteria plan, its subsidy would equal the marginal tax on $12,000—a rate of about 15% if only federal payroll taxes are counted, plus an extra 15% if the household owes federal income taxes, much less than the direct federal subsidy to the exchange. Both the worker and the firm could be better off in this case if the firm dropped coverage given the much larger federal subsidy on the exchange~~.~~.

At the other extreme, consider a firm with 100 workers, 98 of whom have incomes above 400% of poverty, but with two employees with an income low enough for subsidized coverage in an exchange. Such a firm would be foolish to cancel coverage and send all workers to an exchange, because doing so would (according to economists) cost all workers their tax exclusion (which could be 40% of premiums for high wage workers) and cost someone the $2000 per worker penalty from dropping coverage. Only the two low wage workers would gain. A firm with many high wage workers and some low wage workers probably should not even think about dropping coverage unless the aggregate amount of subsidies its workers could get in exchanges was more than the aggregate value of the tax exclusion.

The obvious point is that if the high wage employer has to increase the money wage to offset shifting all of the cost of benefits to workers, it will be less advantageous to the firm to drop coverage than if little or no such offset was needed; this point has been made by some other more measured consulting firm reports (Justice 2012). But the key question the firm should ask is *how much* of its former premium payment it would have to offset to continue to hire the number and type of workers it needs.

Here is one benchmark. If the firm has not previously been paying higher money wages than it needed to attract the workers it hires, and if it wants to keep all of those workers, it should not be able to get by with an increase in wages that is anything less than enough to compensate its workers for their now-higher premium payments and taxes. So dropping coverage will be a money-losing proposition, by a large amount for large firms facing a penalty, and by a smaller but still positive amount for small firms even without a penalty.

Of the 121 million privately insured adults under age 65, about half (62.4 million) are over 400% of poverty and would be ineligible for subsidies in exchanges. Expanded Medicaid will presumably substitute for most of those below 139% of poverty. But that will leave 46 million people, almost 40 percent of the privately insured, who will potentially be eligible for subsidies in exchanges (Kaiser Commission on Medicaid and the Uninsured 2012). More than 90 percent of this population has employment based insurance.

The overall short-run estimates of the number of employers who might drop employment based coverage and send workers to exchanges cover a wide range, from about 6% in the CBO estimate (1% according to Medicare actuaries) to as much as 30% in the McKinsey survey. Probably the most reliable though uncertain story comes from a recent Towers Watson survey (Towers Watson/National Business Group on Health 2012) that found, on the one hand, that only 3% of employers said they were likely or even somewhat likely right now to discontinue coverage for active full time employees, but, on the other hand, 70 percent of employers did not think they would likely be offering health insurance benefits in ten years. (But 45% of firms did think it likely they would in 2014 advise their part-time workers, who are usually low income and rarely are eligible for employer coverage anyway, to go to the exchange.)

So what advice can be offered to the pressured and puzzled employer currently offering benefits? It is easiest to say what not to do: do *not* base the decision on the simple but misleading arithmetic that just compares "cost" for benefits now being paid with ACA penalties if they are no longer offered. Rather than using this as autopilot, think about the more difficult question of how much more in cash wages you would have to offer the workers you want to keep (taking account of their different incomes, preferences, and taxes) to make them as well or better off using the exchange compared to your current offering (and its tax breaks). And think about whether you want to retain this workforce or what kinds of workers you want to attract. If the amount you would pay for the workers you want is more if they shift to the exchange than you are paying now, keep offering benefits under the same terms and paying the same wages as you are now doing.

These messages for individual firm behavior do, however, depend on demand at the firm and in the economy as a whole. If demand for the firm's products drops, or if the economy as a whole turns down, many employers offering coverage may be looking for ways to reduce employment by reducing compensation for workers. If so, moving the provision of insurance to exchanges, especially when the blow is cushioned for lower wage workers by the subsidies in the exchange, could prove fatally attractive. The extra penalty will still slow large firms from bailing out, but smaller firms with several dozen workers, who are the backbone of the US economy, may decamp. What happens in the health care and health insurance economies is thus crucially linked to the economy-wide labor market situation.

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