

Why Employers Will Continue to Provide Health Insurance: The Impact of the Affordable Care Act

Timely Analysis of Immediate Health Policy Issues

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Summary

It is no accident that the Affordable Care Act (ACA) was designed and promoted as a way to build on, not replace, the employer-sponsored health insurance that now covers most working-aged Americans. Avoiding displacement of privately financed employer-based coverage was key to achieving politically feasible financing for the ACA's coverage subsidies for low-income households—which are available, through tax credits and Medicaid, only for insurance provided outside the workplace.

Although most analyses, including those done by the Congressional Budget Office (CBO), the Rand Corporation, the Urban Institute and others, have concluded that the law will leave employer-sponsored health insurance largely intact, questions about how the incentives of the law will actually play out remain very much alive. Some benefit consultants' reports of employers' greater-than-anticipated interest in dropping coverage¹ have fueled claims that CBO and others seriously misjudged employers' incentives and significantly underestimated subsidy costs under the ACA. Some prominent economists see the law's incentives as likely to induce a wholesale shift away from employer-sponsored coverage.² Others foresee a more modest but still substantial shift as employers increase employees' premium contributions, thereby encouraging low- and modest-wage workers to take advantage of publicly subsidized coverage.³ In either case, these analysts raise the prospect of public subsidy costs that will be substantially higher than estimated.

The key to the ACA's actual impact on employer-sponsored insurance (ESI) will be whether most workers' employers continue to see their employees as valuing employer-

provided health insurance over the alternative created by the ACA. And, under the terms of the ACA and the pressure of a competitive marketplace, our analysis shows they overwhelmingly will.

The bottom line is that most workers' firms will be dominated by workers who will receive better benefits and, through the tax system, better subsidies through employer-provided coverage than through newly created insurance exchanges. The strength of employee preferences may be hard to read in the short term, and some employers may seek immediate financial gain in benefit reduction as markets adjust to new circumstances. But over time, coverage reductions inevitably would make the workers that employers most want to keep worse off, and if those workers sought employment elsewhere as a result then the firm would be worse off as well. It is therefore unlikely that large numbers of employers currently providing insurance coverage will change their decisions to offer it.

Although projections of future behavior are inherently uncertain, the conclusion by CBO and other analysts that the ACA will leave employer-sponsored coverage intact rests on simulations of the complex interaction of multiple factors in shaping employees', and thereby employers', coverage preferences over the long term. By clarifying these factors, analyzing the way that the ACA does or does not affect them and examining how their influence on employers can be best understood, this brief explains why we believe that most Americans will continue to rely on employers for health insurance coverage even after the major ACA provisions are implemented in 2014.

Employers' Interest In Providing Health Insurance Coverage

Beginning in the 1940s and growing over the next several decades, several factors converged to establish job-based benefits as Americans' primary route to health insurance protection. In brief, insurers learned that they could

lower administrative costs and avoid "adverse selection" (the purchase of insurance only by people who thought they would get sick) by selling to large employers; labor unions took advantage of regulators' determination that health insurance and other fringe benefits were subject to collective bargaining; wage freezes during World War II gave employers a powerful incentive to offer health insurance in order to attract

workers in a tight labor market; and tax policy administratively and then legislatively exempted employer-paid premiums from employees' taxable income, essentially subsidizing its costs. These insurance market, labor market and tax incentives worked together to make workplace-based health insurance better and cheaper than the insurance that employees could obtain on their own. Employers seeking to attract and



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retain workers therefore increasingly came to offer health insurance, and employer contributions to employees' health insurance became an integral part of most workers' compensation.

The dominance of employer-sponsored health insurance did not make it universal. Its availability reflected what employers in different circumstances with different demands for labor found necessary to attract an adequate workforce. Employers able to attract workers at low wages have always been less likely to offer coverage; low-wage workers lack sufficient clout in the labor market to command better wages, let alone better benefits. The level of employers' contributions and the benefits they offer have always reflected variations in health care costs. Small employers, which have had to pay the higher administrative costs per worker associated with providing insurance to small groups, and small and other employers of low-wage workers are less likely to offer—or are likely to offer less generous—benefits. In 2009, only four in ten firms with predominantly low-wage workers provided health insurance, compared with more than six in ten among firms dominated by better-paid workers (see Table 1).

These variations reflect the economic reality, documented by labor economists, that workers bear the full cost of health insurance coverage on average and over time.⁴ For profit-maximizing employers in competitive labor markets, workers' total compensation—the combination of wages and benefits they receive—reflects the value of the contribution workers make to the firm. There is a tradeoff between wages and benefits. Because health costs keep rising and wages can only go so low (given minimum wage requirements and workers' basic needs), employers with predominantly low-wage workers are increasingly less likely to offer health insurance or are more likely to reduce the benefits they offer. As premiums increase, offering health insurance makes it harder to keep compensation equal to the workers' value to the firm. This tradeoff explains the substantial declines in coverage offerings for small firms with low-wage workers over the past decade (Table 1). From 2000 to 2009, the likelihood of predominantly low-wage firms with fewer than 25 employees offering coverage fell almost 30 percent, while in higher-wage firms with fewer than 10 and with 10 to 24 workers, coverage fell 17 percent and 8 percent, respectively.

Rising per capita health care costs relative to average productivity per worker will cause these trends to continue, but they have nothing to do with the ACA. In general, with or without the new law, employers will offer benefits to the extent that their employees value benefits, both in general and relative to wages and to the extent that acceptable wages plus benefits do not exceed what employees are worth to the firm.

Implications of the Affordable Care Act for Employer Decision-Making

The critical question, then, in assessing the ACA's impact is how it will affect employers' assessment of the compensation packages necessary to attract the workers they need. Taking this perspective immediately dispels a common misconception about the ACA's impact: that the penalties the ACA imposes on employers with 50 or more workers that do not provide affordable coverage⁵ will have the perverse effect of leading employers who already provide coverage to drop it. Because the penalty is less than the cost of health insurance, some skeptics have argued that a simple cost calculus will lead employers to drop coverage.

Table 1. Percentage of Private Sector Establishments That Offer Health Insurance, 2000 and 2009, By Firm Size and Wage

	Number of Employees					
	All Sizes	<10	10–24	25–99	100–999	1,000+
All Firms						
2000	59.3	39.6	69.3	84.5	95.0	99.2
2009	55.0	33.6	62.5	81.6	94.3	99.2
Percent Change	-7.3	-15.2	-9.8	-3.4	-0.7	0.0
Firms With 50% or More Employees Low Wage						
2000	42.5	25.4	46.3	73.5	94.2	96.4
2009	41.0	17.9	32.8	59.5	88.7	98.5
Percent Change	-3.5	-29.5	-29.2	-19.0	-5.8	2.2
Firms with Less than 50% Employees Low Wage						
2000	64.7	50.2	83.4	92.4	96.9	99.4
2009	62.2	41.7	76.4	91.4	97.1	99.7
Percent Change	-3.9	-16.9	-8.4	-1.1	0.2	0.3

Taken from: McMorrow S, Blumberg LJ and Buettgens M. *The Effects of Health Reform on Small Businesses and Their Workers*. Washington: Urban Institute, June 2011.

Source: Agency for Healthcare Research and Quality, Center for Cost and Financing Studies. 2000 and 2009 Medical Expenditure Panel Survey—Insurance Component

But that argument ignores the fact that employers have been offering coverage for decades, with no threat of a penalty for not doing so. They do it for good economic reasons—they are competing for labor—and these economic reasons will determine whether they continue to do so or change their behavior.

What matters most here is not the ACA's penalties —though, as we will see, the penalties will be a factor in employer decisions. Rather, the ACA's establishment of a subsidized alternative to workplace coverage may undo, for some employees, the relative financial attractiveness of employer-sponsored coverage. The ACA's impact on ESI will depend on whether, given the alternatives the law creates for coverage outside the workplace, employers will still see offering coverage as essential to attracting and retaining the workforce they want.

The ACA's combination of tax subsidies and a newly effective nongroup insurance market means that, for some workers, health insurance coverage becomes a better deal outside than inside the workplace. But the law, with some limited exceptions,⁶ does not allow workers who are offered employer-sponsored coverage to take advantage of that deal. Some argue, therefore, that employers have an opportunity to make their employees better off and improve their company's bottom line if they drop coverage, pay the penalty, and, increase employees' wages as necessary to cover any increases they face in health care costs. The assumption that this win-win proposition (better-off workers at lower employer costs) applies to large numbers of large employers has led to claims that employers will drop coverage in droves.

Witness the following from a *Washington Post* op-ed from Wisconsin Senator Ron Johnson and former CBO Director Douglas Holtz-Eakin:

There are many employers who would happily get out of the practice of providing health insurance, if they could do it without hurting their workers. Obamacare will encourage them to do so. In the current system, most employers are highly

reluctant to drop health coverage for employees because they don't want their workers to be financially exposed. But under Obamacare, instead of paying \$15,000 for family coverage, an employer can choose to pay a \$2000 fine, pay more in cash wages, make his employees eligible for a huge government subsidy and come out ahead. Confident that their employees are also gaining, millions of employers will follow this logic.

Tens of millions of workers will be given the opportunity to take advantage of those subsidies. It makes no sense that just a few million will wind up in exchanges.... If...all American employees wind up in the exchanges—which we believe is a goal of Obamacare—then the annual cost of the exchanges would increase by more than \$800 billion.⁷

That some workers now benefiting from ESI would be better off in exchanges is a fact—as described below. But a leap from that fact to the conclusion that employers have a powerful incentive to drop coverage runs counter to standard economic theory. First, over time, a competitive labor market will not allow employers to save money by dropping employer-sponsored coverage. As explained above, employers pay workers a combination of wages and benefits at a level equal to the employee's value to the firm. The market will keep compensation at that level, whether employers pay a worker's value only in wages or in some combination of wages and benefits. If, in total, an employer compensates workers less than their value, that employer will lose those workers to competitors who offer them more. If, alternatively, an employer pays workers more than their value, the firm will lose money. That means, plain and simple, that in a competitive market, employers cannot “come out ahead” by dropping coverage and at the same time reducing compensation.

The challenge to this argument, of course, is that the marketplace is not “perfectly” competitive or, more narrowly, that it takes a while

for competitive forces to play out. Employers that respond positively when asked about dropping health insurance may be focused on immediate opportunities for financial advantage and the understandable desire to simply pay wages, rather than hard-to-manage health insurance costs. It is clearly a challenge to constrain wages to offset ever-increasing health insurance premiums. Some employers may therefore “miss the mark” in the short term—cutting benefits and underpaying some workers, in order to compensate others for the benefit loss, as the predictors of large-scale dropping claim. But the market will ultimately eliminate any underpayment, force these employers to adjust and bring total compensation into line with workers' value.

In short the “win-win” proposition posited as inducing wholesale dropping ignores market realities. Over time, if benefits decrease, wages increase—and the total cost to the employer will be the same—equal to the worker's contribution to the firm's revenues. What will ultimately drive benefits is therefore not savings to employers but whether the workers that employers most want to keep actually want them to continue providing benefits.

Given the way the ACA works, it is highly likely that they will, posing the second significant challenge to the rampant dropping argument. Under the ACA, only some workers—the lower-paid, lower-skilled workers—will benefit from the ACA's exchange subsidies. Most employers hire a mix of workers who face different circumstances and have different preferences (e.g., some high income, some low income, some healthy, some not, some with families, some single). But a decision not to offer coverage affects all workers at the same time. Not all workers will be pleased with any one decision, and evidence suggests that the preferences of workers that are the most difficult to replace (e.g., highly skilled, often higher earners) will tend to carry the most weight in employer decision-making.⁸ These workers do not benefit from exchange subsidies and are likely to have a strong

preference that the employer continues to provide coverage.

Analysts who predict widespread dropping argue that employers can compensate these workers for the loss of benefits. In so doing, however, they ignore the way markets adjust over time. Even if an employer drops coverage, the market will constrain workers' total compensation to the value they bring to the firm. In a competitive market, any workers not paid in full will be lost to competing firms. That means that employers have no way to make money on workers who are happy with the change and use the savings to compensate those who are not. The competitive labor market requires them to pay wages to offset benefit reductions even for workers made better off by dropping. If they compensate workers made worse off, they will increase their total compensation costs. Dropping health insurance in that context will therefore lead to increased costs, not savings, to the firm.

The Costs and Benefits of Employers' Decisions to Drop Coverage: Who Wins and Who Loses?

Predictions of rampant dropping not only ignore fundamental challenges to employers' ability to balance the interests of winners and losers, they also ignore fundamentals that will determine who winners and losers actually are. A look at new subsidies under the ACA, continuing tax subsidies under current law, and the characteristics of workers reveals the following points:

In general, better-paid workers remain better off with employer-sponsored coverage. The attractiveness of the exchange relative to employer-sponsored coverage rests on the availability of equally or better-subsidized coverage for equivalent benefits. Employees purchasing coverage in the exchange lose the tax benefits associated with work-based premiums and will have to pay premiums with after-tax dollars. ESI premiums are excluded both from federal and state

income taxes and from payroll taxes—those who foresee widespread dropping tend to ignore the payroll tax and state income tax advantages.⁹ Employees who drop ESI will need equivalent or greater subsidies in the exchange to offset this loss.

The ACA subsidies—tax credits that limit premium expenses as a share of income—are available to people in families with incomes from 138 percent¹⁰ to 400 percent of the federal poverty level (\$30,843 to \$89,400 for a family of four in 2011). Maximum premiums range from 3 percent of income for families with incomes at 138 percent of the poverty level to 9 percent for families with incomes at or above three times that level.¹¹ Exchange-based subsidies decrease as income increases, but the opposite is true for tax subsidies for employer benefits, which increase as income increases.

In general, if an employer drops coverage, better-paid workers will be worse off. Even if they receive higher cash wages to offset the loss, they will face taxes on these wages which, keeping overall compensation at the level of their value to the firm, will not be offset. Exchange benefits will also be unattractive, relative to employer-provided benefits, for better-off earners. Exchange-based subsidies are limited to plans with an actuarial value no greater than 70 percent, a value much lower than provided by the typical ESI plan (85 percent).¹² Although lower-wage workers can receive cost-sharing subsidies to enhance this value, subsidies decline with income. Subsidies leave out-of-pocket burdens significantly higher than in typical employer-sponsored coverage for families with incomes between 201 percent and 250 percent of the federal poverty level and phase out completely for families whose incomes exceed 250 percent of that level.¹³

Regardless of their perspective on dropping, analysts agree that it is only at or below an income of 250 percent of the federal poverty level that the ACA's combination of premium tax and cost-sharing subsidies makes exchange coverage, on average, as good as or better

than tax-subsidized employer-sponsored coverage.¹⁴ Nondiscrimination rules impede employers' ability to simply decide not to offer coverage to workers who have access to subsidies in the exchange while offering it to workers who do not. To deny coverage for those eligible for subsidies, they would have to drop it for everybody and therefore face a penalty—\$2,000 per full-time employee—applied across all but the first 30 workers in firms with more than 50 workers (not just to those who participate in the exchange).

In addition to paying the penalty, keeping all workers “whole” would require that employers pay additional wages both to cover extra unsubsidized premium and benefit costs (for workers eligible and ineligible for subsidies) and to offset the fact that any premium payments would now be paid by employees out of after-tax, not pre-tax, dollars. But, as explained above, employers would not be able simply to “pocket” savings from having the government subsidize their workers' health care. They would have to pay subsidized workers their value in wages, along with any extra benefit costs, and would have to do the same for unsubsidized workers—and also would have to pay penalties. The result would be an overall increase in the firm's compensation costs, which would make firms worse, not better, off.

Within firms, “losers” from dropping far outnumber “winners,” on average. Taking all this together, employers would only be likely to drop coverage if most of their workers would benefit from the exchange—in which case they could substitute extra wages for benefit reductions. But, because offsetting payments would increase their compensation costs, employers are not likely to drop coverage if most of their workers would not benefit from the exchange. Claims of widespread dropping focus on the overall number of wage earners who would “win,” rather than on their distribution within firms. But when an employer contemplates a decision to drop coverage, it is the distribution of income among the firm's employees that matters.

Thinking about a firm's specifics, an employer whose firm is dominated by workers earning less than 250 percent of the federal poverty level would be highly likely to drop coverage. Most of the firm's workers would benefit from subsidies in the exchange, and the employer could replace benefits with wages (less penalties)—to keep compensation equal to the worker's value and thereby keep the worker—without increasing total compensation. At the other end of the spectrum, a firm dominated by workers earning incomes well above 250 percent of the federal poverty level would not be likely to drop coverage, since most of its workers would not receive subsidies in the exchange and increasing their wages to offset lost tax benefits and extra benefit costs (along with penalties) would mean paying workers “too much” relative to their worth, increasing rather than decreasing the firm's total costs.

Data on the distribution of worker incomes within firms are notoriously difficult to come by. Employer surveys can collect data only on wages, not incomes (since employers do not have information about households, only what they pay their own workers). Household surveys can collect data only on the particular sampled households, not the other workers with whom any given household members might work. However, we do know that only about one in five workers with their own ESI coverage has income below 250 percent of the federal poverty level (see Table 2). Given this distribution, the share of workers who would benefit from

dropping—based on income and subsidy calculations alone—will likely be far smaller than the share of workers who will not. If the firm dropped coverage, compensating all workers for lost benefits would increase employers' total compensation costs. These employers, therefore, will have a disincentive to drop coverage.

Complexities in assessing “winners” and “losers,” increase reluctance to drop. Further reducing the likelihood that employers will drop coverage is the difficulty in a mixed-wage firm of assessing predominant coverage preferences among employees. Where there are few high-wage workers and a lot of low-wage workers, or the opposite, predominant preferences may be relatively clear. But where there is a mix, which is most often the case, assessing preferences will be complicated by workers' particular circumstances—factors not taken into account by those who claim that dropping will be widespread. Factors that make dropping particularly unattractive to workers include the following:

- Age—Because the ACA allows insurers in the exchange to charge higher rates to older workers (albeit to a more limited extent than occurs in today's nongroup market), these workers or their family members would be particularly averse to an employer decision to drop coverage. Higher-income workers tend to be older than lower-income workers. In large firms, half of workers with incomes above

250 percent of the federal poverty level are between the ages of 45 and 64.¹⁵

- Smoking—The ACA also allows insurers in the exchange to charge higher but still constrained premiums to smokers. Smokers are disproportionately represented among low-wage workers,¹⁶ whose subsidies will not be increased to reflect the higher premium cost. As a result, low-wage workers who smoke might actually be averse to having their employer drop coverage.
- Family status—Although, in general, the ACA subsidies make exchange coverage relatively attractive to low-wage workers, family circumstances may actually make exchange coverage unattractive. For example, a low-wage worker with income from an employed spouse may not be eligible for subsidies in the exchange. Each family's preference will reflect its own set of health insurance options and their respective values. Families will face different options and will value them differently based on their own health characteristics, willingness to take on risk, preferences for particular benefits and the relative prices of the choices before them.

Family preferences will be further influenced by the uncertainties about newly established coverage mechanisms. Employees may be reluctant to lose access to an employer's assistance in assuring access to benefits under a plan. Or, even more important, employees may be reluctant to replace benefits

Table 2: Workers in Offering Firms with Own ESI Coverage

Firm Size Group	Worker's Income	N	% Within Firm Size Group	% With Single Policy	% Within Age 45 - 54	% Within Age 55 - 64
100 or Fewer Employees	Under 250% FPL	4,918,974	26.98%	65.33%	20.39%	11.47%
	Over 250% FPL	13,312,462	73.02%	66.89%	28.37%	20.70%
101 - 1000 Employees	Under 250% FPL	3,368,409	19.59%	62.83%	20.76%	12.42%
	Over 250% FPL	13,829,047	80.41%	62.25%	29.52%	18.48%
Over 1000 Employees	Under 250% FPL	7,404,683	19.20%	65.99%	20.96%	10.88%
	Over 250% FPL	31,163,249	80.80%	60.36%	30.10%	20.22%
All Firm Sizes	Under 250% FPL	15,692,066	21.21%	65.10%	20.74%	11.40%
	Over 250% FPL	58,304,758	78.79%	62.30%	29.56%	19.92%

Taken from: Garrett B and Buettgens M. *Employer-Sponsored Insurance under Health Reform: Reports of Its Demise Are Premature*. Washington: Urban Institute, January 2011.

subject to terms of employment with a public subsidy subject to “reconciliation” at the year’s end. The ACA requirement that an employee whose family income changes over the year pay back the value of tax credits deemed “excessive” may significantly reduce the attractiveness, relative to ESI, of even a seemingly valuable credit.

Given the complexity of employees’ preferences, which an employer would be hard-pressed to assess or to synthesize, a decision to drop coverage exposes an employer to the risk of undermining worker loyalty, increasing worker turnover and disrupting rather than enhancing employees’ benefit expectations. Deciding whether and when to take that risk is far more complicated—and less likely—than a simple subsidy calculus might suggest

Encouraging “winners” to drop voluntarily, rather than dropping coverage overall, cannot overcome these barriers to dropping. Some analysts have identified a potentially less risky alternative strategy to accommodate the interests of low-wage workers with less disruption to higher-wage workers.¹⁷ This strategy would have employers continue to offer coverage but reduce the employer’s contribution to premiums so that the low-wage employee’s share exceeds 9.5 percent of income—the point at which the ACA allows employees to receive subsidies in the exchange, even if their

employers actually offer coverage. In these circumstances, employers would still face penalties but potentially smaller ones—the lesser of \$3,000 per worker receiving a subsidy or \$2,000 per full-time employee. And, these analysts argue, the costs of compensatory wage increases for workers who continue to prefer employer-sponsored coverage would be less than if the employer had dropped coverage—limited to the amounts necessary to offset higher employee contributions for those staying in the firm’s plans.

This idea posits a limited “win-win” proposition, but it suffers from the same logical and operational fallacies as the full-scale dropping argument and would pose some additional problems for an employer who tried it. First, and probably foremost, this strategy incorrectly assumes that the employer can actually save money on the employees who switch to the exchange. In fact, a competitive market will force them to increase wages for these employees; if they do not, they will lose workers to a competitor who will. Over time, employers cannot pay workers less than they are worth.

Second, there will be no “extra” money to pay the penalties the firm will incur for all the workers who use the exchange.¹⁸ Firms that make the necessary wage adjustments to keep workers plus paying penalties would be increasing their total spending, not reducing it as proponents suggest.

There is also a third problem. Analysts who have explored this strategy, like analysts who foresee large-scale dropping, fail to account for workers’ particular circumstances like age, smoking habits and family status. Lower-paid workers likely to benefit from the exchange are also likely to be younger workers. If they voluntarily drop ESI coverage and go into the exchange, the employer will remain responsible for the older (and, more important, sicker and costlier) workers, without the ability to spread those costs across all workers’ wages. For the employer to avoid an increase in total compensation, that means higher premium contributions and lower wages for those who stay—likely for the very workers the employer most wants to keep. The result is similar if nonsmokers leave and smokers stay, or if single workers leave and families stay. Again, the employer retains the more costly population and either increases total compensation or raises everyone’s premium contributions to cover the higher costs per insured. This is a losing proposition for employers, even though some employees will indeed be better off. Just like dropping, it is a strategy that most employers are unlikely to pursue.

Predicting the Future of Employer-Sponsored Insurance

On its face, the idea that the ACA offers employers a “win-win” proposition—making their workers better off and, at the same time, improving the firm’s bottom line—seems awfully attractive. But whether it comes to an employer’s decision to drop coverage or, more modestly, to increase employees’ contributions to encourage low-wage workers to drop coverage on their own, in a competitive marketplace the “win-win” ultimately does not exist. The grain of truth to the “win-win” argument lies in the space between “ultimately” and now. In the short term, as markets adjust, some employers may seek a financial advantage that they cannot sustain over time—escaping the burden of providing health benefits and, at the same time, reducing their overall

Table 3: Changes in ESI Coverage Due to the ACA

	Without Reform	ACA	% Diff
Total ESI			
Persons covered	151.6	151.2	-0.3%
ESI Policyholders and Coverage (in millions)			
Single policyholders	44.4	46.5	4.9%
Family policyholders	27.5	27.5	-0.2%
Persons covered	127.9	129.5	1.2%
Coverage Where No Policyholder is Identifiable¹ (in millions)			
Persons covered	23.7	21.7	-8.5%

Taken from: Garrett B and Buettgens M. *Employer-Sponsored Insurance under Health Reform: Reports of Its Demise Are Premature*. Washington: Urban Institute, January 2011.

Source: Urban Institute analysis, HIPSM 2010.

¹Persons in the CPS reporting ESI coverage when no policyholder is present in the household.

compensation costs. Even in the short term, that strategy poses the risk of misjudging their employees' preferences and competitive pressures, causing them to lose employees to competitors that are less willing to take a chance. And, as competition plays out, the inability to hire and keep the types of workers they most want will lead them to readjust their coverage and compensation accordingly. Markets will adjust, and it will be employees' preferences, not employers' financial gain, that determine the future of ESI.

The future is uncertain, in large part because it is difficult for employers to predict the detailed and complex view of employees' options, coverage valuations and resulting preferences that underlie

the decisions that employers ultimately make. The best microsimulation models approximate these detailed and complex views, which then allow family preference computations, which in turn allow the simulation of employer decisions based on worker preferences as the marketplace unfolds. Using these models, the Urban Institute, CBO and others have concluded that overall employer-sponsored coverage under the ACA would not differ significantly from what coverage would be without it. Table 3 shows this effect, as simulated using the Urban Institute's Health Insurance Policy Simulation Model (HIPSM).

Confidence in this prediction is increased by experience in Massachusetts, whose 2006 health

reform legislation adopted changes to the landscape of employee and employer choices quite similar to the ACA's. In Massachusetts, the rate of employer-sponsored coverage increased about 3 percent from fall 2006 to fall 2009, a period covering both the implementation of the state reforms and a sizable increase in the state unemployment rate.¹⁹

Although no prediction is certain, the most thorough analysis, validated by Massachusetts' real-world test, supports the conclusion that the ACA, as intended, leaves employer-coverage intact, even as it creates a viable insurance market for people who ESI fails to reach.

Notes

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- Penalties under the law, which apply only to employers with 50 or more full-time employees, operate as follows: An employer that does not offer coverage and has at least one full-time employee receiving a tax credit to subsidize the purchase of insurance in the exchange is fined \$2,000 on all full-time employees (minus the first 30). An employer that offers coverage but nevertheless has at least one full-time employee receiving a tax credit to subsidize the purchase of insurance in the exchange is fined the lesser of \$3,000 for each employee receiving a credit or \$2,000 for all full-time employees (minus the first 30).
- The ACA provides an "affordability" exception for workers for whom the employee's premium contribution for single coverage exceeds 9.5 percent of income or for whom cost-sharing reduces the share of services covered by the employer's insurance plan (the actuarial value) below 60 percent. These exceptions are narrow and allow employers to modify worker contribution levels and benefits provided in order to reduce the number of workers eligible for subsidized exchange coverage still further. Employers with more than 100 workers are not bound by the ACA's essential health benefit minimums, giving larger firms tremendous flexibility in plan benefit design.
- Johnson R and Holtz-Eakin D. "Obamacare, the Runaway Entitlement," *Washington Post*, June 17, 2011, p. A23.
- Gruber J and Lettau M. "How Elastic Is the Firm's Demand for Health Insurance?" *Journal of Public Economics*, 88(7-8): 1273-1293, 2004.
- Garrett B and Buettgens M, *Employer-Sponsored Insurance under Health Reform: Reports of Its Demise Are Premature*. Washington: Urban Institute, January 2011; Holtz-Eakin and Smith. *Labor Markets and Health Care Reform*.
- Tax credits are available to people not eligible for Medicaid. Medicaid eligibility is available to families with incomes up to 133 percent of the federal poverty level. However, because 5 percent of income is "disregarded" in calculating family income, eligibility is effectively extended to 138 percent of the federal poverty level.
- Legal permanent residents who are not eligible for Medicaid are eligible for tax credits at incomes below 138 percent of poverty. Their premium shares are limited to 2 percent of income.
- Yamamoto D, Neuman T and Kitchma Strollo M. *How Does the Benefit Value of Medicare Compare to the Benefit Value of Typical Large Employer Plans?* Issue Brief No. 7768, Washington: Kaiser Family Foundation, September 2008.
- Cost-sharing subsidies raise the actuarial value of exchange plans to 94 percent for families with incomes up to 150 percent of the federal poverty level; to 87 percent, for families with incomes between 151 percent and 200 percent of that level; and to 73 percent for families with incomes between 201 percent and 250 percent of the federal poverty level.
- Holtz-Eakin and Smith, *Labor Markets and Health Care Reform*; Garrett and Buettgens, *Employer-Sponsored Insurance*.
- Garrett and Buettgens, *Employer-Sponsored Insurance*.
- Goszkowski R. "Among Americans, Smoking Decreases as Income Increases." Gallup, March 21, 2008. <http://www.gallup.com/poll/105550/among-americans-smoking-decreases-income-increases.aspx>.
- Burkhauser, Lyons and Simon. *The Importance of the Meaning and Measurement of "Affordable."*
- The employer can offset the increase in the worker's premium share with additional wages that the employee can place in a tax-favored premium account (up to \$2500). As a result, the employer would not face the challenge of offsetting new tax burdens that arise if the employer drops coverage altogether.

Currently, tax-favored accounts without limits qualify as employer plans. Depositing wages equivalent to the full premium cost into such accounts—the necessary offset if coverage is dropped altogether—would not, therefore, eliminate the employer plan, and workers with a plan are not eligible for exchange subsidies.

¹⁹ Long SK and Stockley K. *Health Reform in Massachusetts: An Update as of Fall 2009*. Washington: Urban Institute, 2010.

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