

How will employers respond to coverage reforms: Issues for policy-makers and modelers

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THIS BRIEF EXAMINES FOUR IMPORTANT QUESTIONS:

1. Why should policy-makers care?
2. What drives the employer decision to offer coverage?
3. Who pays for coverage?
4. What assumptions do modelers make about employer behaviors and what impact do these assumptions have on model results?

Why should policy-makers care?

- **Policy-makers need to understand how employers will respond to tax credit proposals or public coverage expansions, and what drives these decisions.** Employers might respond to new public coverage or tax credit options in a variety of ways:

- Some might change their decision to offer (or not to offer) coverage.
- Others might change their employee contribution requirements.
- As a result, some currently insured workers might lose coverage.

An employer's decision to drop coverage or change employee contributions will affect all workers, not just those with access to new coverage options. Thus, the implications of coverage policies are far broader than focusing on the target population alone might suggest.

- **The question of who bears the cost of health insurance is also a critical issue for policy-makers examining employer responses to coverage proposals.** If workers always bore health insurance costs in the form of reduced wages, it would not so much matter whether workers got coverage on their own or through their employers (although coverage through an employer might still be less costly because of risk pooling and economies of scale). Thus, an employer's decision to drop coverage might not be very problematic. But if we find that employers do bear some of the cost of coverage or that costs are spread unevenly among workers, employers' decisions to drop coverage would leave some workers worse off.

- **Finally, policy-makers need to understand how modelers predict employer responses to new coverage policies, which are among the strongest drivers of model results.** There is a lot of uncertainty about how employers will respond to coverage policy changes. Because of this uncertainty, different models incorporate different assumptions about how employers will respond. It turns out that these assumptions—and employer behavior—are very important to model results. Changing assumptions about employer behavior can fundamentally shift predictions of coverage policy results.

What drives the employer decision to offer coverage?

■ **Employers offer coverage primarily because workers want it.** This approach has several advantages for workers:

- **It is tax-favored:** Employees do not pay taxes on employer-sponsored health coverage benefits.
- **It produces economies of scale:** The administrative “load” costs are much higher for individuals and small firms than they are for larger employers.
- **It helps avoid adverse selection:** Providing insurance through employment is a reasonably good way to pool risks, and limits the potential for adverse selection found in the nongroup market.
- **It can produce multiple year insurance coverage:** Assuming low job turnover and stability in the offer decision, workers can have a stable source of coverage for several years through their employer.

■ **The employer offer decision is affected by many factors.**

- Employers face competition in hiring and retaining workers and must offer benefits that are attractive to their employees.
- Workers have diverse preferences and employers are more likely to respond to the preferences of the most valuable and hard to retain workers—usually those most highly paid.

■ **Several firm characteristics are linked to a lower or higher likelihood of offering health insurance coverage.**

Firms are more likely to offer if they:

- Have more high-wage workers relative to other firms.
- Are in the manufacturing and public sectors or are unionized.

Firms are less likely to offer if they:

- Are small, but small firms with high-wage workers are more likely to offer than are small firms with low-wage workers.
- Employ many workers with access to coverage through a spouse.

Who pays for coverage?

■ In aggregate—that is, at the national level—economic theory states and research shows that health insurance costs are shifted to workers in the form of lower wages.

■ But both studies and everyday experience suggest the theory does not fully apply at the individual and firm level.

- At the individual and firm level there is evidence that workers do not fully bear the cost of their coverage, suggesting there is risk spreading within the workplace. Several facts support this conclusion:
 - **Many studies show that the absolute amount the employer pays for coverage has no impact on workers' decisions to take up that coverage.** If workers bore the full cost of coverage they would respond to the full cost of the premium.
 - **If workers drop or do not take up coverage, their wages do not increase.** Theory suggests that wages would increase if a worker dropped coverage, but this does not generally occur.
 - **Within a firm, workers of a given age with higher health care costs do not appear to pay more for coverage in the form of lower wages.** A possible exception to this is workers in very small firms, where higher cost workers may pay more.
 - **Workers are less likely to take up coverage if they must pay more of the premium out of pocket.** If workers did pay the full cost of coverage, employers would not try to shift the cost of health insurance premiums to workers and those workers would not respond to increases by dropping or not taking up coverage.

What assumptions do modelers make about employer behaviors? What impact do these assumptions have on model results?

- **Workers' diverse preferences are not always reflected in models or are reflected in different ways, with an impact on simulation model results.** Modelers have two main choices for estimating the preferences of diverse workers within firms: assume that each worker in a national sample survey is representative of his or her firm (e.g., assign each worker the average or median value); or use simulated firms through which individual workers are attributed preferences and aggregated according to modeler assumptions about firm composition. Modelers use this synthetic modeling strategy because none of the data sources used for models tie workers and their preferences to firms and firm characteristics.
- **The simulated firm approach allows the modeler to value some employees' preference over others.** This attribute is helpful given that employers seem to give greater weight to higher-wage workers' preferences than to those of lower-wage workers. Faced with a policy proposal to change the tax treatment of employer-sponsored insurance, models that incorporate firms' greater weighting of the preferences of higher paid workers produce much greater changes in employer offer rates than models that make decisions based on the preferences of the median worker within the firm. Despite its wide use, however, the synthetic firm approach is not particularly robust, as it relies on a relatively weak body of evidence about the composition of firms (including the age and earning distributions of the workers), the preferences of different groups and the weight employers place on each of the different preference groups.

Conclusions

- > **The first and main conclusion of this work is that employer responses to new coverage policies will have a big impact on the results of those policies, but there is uncertainty about how employers will in fact respond.**
- > **This uncertainty is reflected in modelers' divergent assumptions about how employers will respond to new coverage policies.** So another conclusion for policy-makers is that multiple model results are better than one. Examining results of multiple models can help policy-makers appreciate the range of potential employer responses and gauge the certainty or uncertainty of results.
- > **This information also points to two additional conclusions for policy-makers.** First, approaches that draw higher-wage workers out of employer coverage will be more likely to cause employers to drop coverage than approaches that pull out lower-wage workers. Second, any policy that causes employers to drop coverage may leave workers worse off. This conclusion is based on evidence that workers do not fully bear the cost of their own employment-based coverage and that employers enjoy economies of scale in purchasing coverage not enjoyed by individuals.

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