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eriu RESEARCH HIGHLIGHT

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Can the Employer-Based Health Insurance System Reduce America's Uninsured?

THE PROBLEM

More than two-thirds of non-elderly individuals in the U.S. are insured through their employer. An economic downturn is putting this predominant source of coverage at risk as companies lay off workers. The number of uninsured Americans increased to 41.2 million in 2001. Although a slow economy and rising health insurance costs could further increase that number, policymakers continue to look to employer-based solutions to expand coverage.

What leads two-thirds of companies to offer coverage and 82 percent of employees to accept such offers? A review of the research, conducted for The Economic Research Initiative on the Uninsured by economists Linda Blumberg, Ph.D., of The Urban Institute and Len Nichols, Ph.D., of The Center for Studying Health System Change, shows that employer decisions to offer insurance, and employee decisions to take it, are driven largely by premium rates, the tightness of the labor market, and availability of insurance elsewhere.

However, questions about the size of these effects remain unanswered. We don't know how newly proposed tax incentives will change employer behavior, or how firms weight differing employee preferences between health insurance and higher wages. Understanding what motivates employers and workers is critical for determining the fate of new incentives or programs for expanded coverage, particularly as employers face challenges that could deter them from offering health insurance.

POLICY PERSPECTIVE

To extend coverage to uninsured individuals, President Bush, Senate Majority Leader Bill Frist (R-TN), and others favor increasing coverage in the private non-group market through individual tax credits. Other policymakers favor building on the existing employer-sponsored system of health insurance through subsidies aimed at employers.

The most efficient structure for these subsidies is not obvious. It is difficult to target just those firms not offering insurance and just those workers who decline an offer because of expense. It also isn't clear what size subsidy is needed to change behavior. Which employers and employees are at the tipping point of change, and what size subsidy is needed to push them over the edge? Knowing that the intervention will have a positive effect is only half the solution. To cure the problem, policymakers also need to get the dosage right.

– Catherine McLaughlin, Ph.D.
Professor at the University of Michigan and Director of ERIU

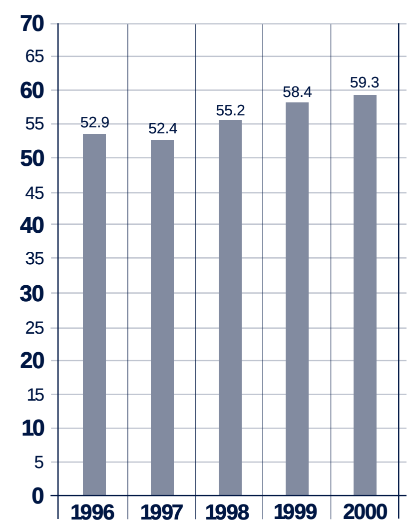
THE FACTS

> **Employee factors affect whether employers offer coverage.** Employers offer insurance when their workforce shows a preference for health care coverage, when competition in the labor market demands that employers offer it, and when they can pass health insurance premium costs back to workers through higher out-of-pocket costs or lower wages.

> **Employees trade wages for health insurance.** While workers in firms offering insurance have higher wages on average than workers without offers, studies show that workers bear a large portion of insurance costs through reduced wages. Premium costs lead some to forego coverage altogether. About 20 percent of workers offered employer coverage decline it; three-quarters of those have health insurance through another source, such as a spouse's employer. Those remaining uninsured tend to blame high premiums.

> **Employers offering coverage tend to be large.** While nearly sixty percent of firms offered health insurance in 2000, offer rates varied dramatically depending on the size of the company. Virtually all firms with at least 200 workers offer coverage compared to 39 percent of firms with fewer than 10 workers.

Percentage of Private Firms that Offer Health Insurance



Source: Health Insurance Component Analytical Tool (MEPSnet/IC). December, 2002. Agency for Healthcare Research and Quality, Rockville, MD.

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Q&A with Linda Blumberg, Ph.D.

Linda J. Blumberg, Ph.D., senior research associate at The Urban Institute, has spent a decade studying health insurance issues. Blumberg co-authored the paper, "Why are so Many Americans Uninsured? A Conceptual Framework, Summary of the Evidence and Delineation of the Gaps in our Knowledge."

Q: *We know employers consider overall preference of workers, competition for labor and cost of insurance when offering insurance. What don't we know about employers' decision-making in this area?*

A: We don't know exactly how employers take preferences of different workers and weigh them in order to decide whether to offer health insurance. We don't know how employers pass the costs of health insurance back to their workers.

Q: *Why do some workers turn down employer-based insurance when it's offered?*

A: Workers are sensitive to price, especially out-of-pocket price. The biggest reasons individuals decline offers of health insurance are that it's too expensive and they have other coverage sources available, such as through a spouse's employer.

"We don't know how employers take preferences of different workers and weigh them in order to decide whether to offer health insurance."

Q: *How would tax credits for insurance purchases in the private non-group market affect the supply and demand of employer-sponsored insurance?*

A: Many young and healthy people in a firm may determine it is more attractive to use tax credits to purchase health insurance in the non-group market than through their employer, especially if these workers perceive they may get some wages back if their employer stops offering insurance. Insurance is likely to be more expensive in the non-group market for employees who are older or have health problems, so they are less likely to take advantage of tax credits.

But are those who use tax credits really going to get wages back? That's an open question. Also, overall demand for health insurance in a firm declines if some workers opt for the non-group market. How does that affect the decision of the employer to offer or not? We don't really know. In the extreme, you could see young, healthy workers wanting to get health insurance through the non-group market with a tax credit, as it would potentially be less expensive. Healthy workers' preferences could lead the employer to drop coverage, and older workers and higher-cost workers, who would find it difficult to access affordable health insurance premiums in the non-group market, are then left to their own devices.

Q: *What should policymakers think about?*

A: How do we subsidize low- and moderate-income individuals and increase their purchasing power? How are risk pools affected by reforms under consideration? This is of critical importance but often lost in the debate. How is risk spread within the contours of a reform? How is the mix of risks changing as a consequence of changing incentives between different types of insurance options? To the extent that risk is segmented so much that individuals who are high-cost or high-risk have to bear all costs themselves, these individuals will be even more vulnerable. Or, if we create some additional pooling, but don't spread risk broadly enough, we may end up scaring off low-risk individuals. So we need to think very carefully about designing mechanisms for spreading risk as broadly as possible so we don't end up making the existing situation worse.

UPCOMING

This Research Highlight is the third in a series of research-based policy documents that will address current questions and issues related to the health care coverage debate. The next Research Highlight will examine subsidies to employer health insurance programs. Research Highlights can be found on ERIU's website at www.umich.edu/eriu.

Funded by The Robert Wood Johnson Foundation, ERIU is a three-year program shedding new light on the causes and consequences of lack of coverage, and the crucial role that health insurance plays in shaping the U.S. labor market. The Foundation does not endorse the findings of this or other independent research projects.

For text of full interview, visit ERIU's website at www.umich.edu/eriu.