



# Health Policy Brief

January 15, 2010

**Employer Mandate:** Congress is negotiating final details of proposed requirements that employers pay a substantial share of their employees' health insurance or subsidize coverage of the uninsured.

## What's the issue?

Employers provide health insurance coverage to almost three in five Americans under age 65, or more than 160 million workers and their families. As such, employment-based coverage is considered the bedrock of America's health insurance system. But not everyone with a job has health insurance. In 2006, nearly 13 percent of full-time workers had no health insurance at any time during the year. Two-thirds of the 46 million non-elderly people without coverage in 2008 were in families with one or more full-time workers.

To shore up the system of employment-based health coverage, and to extend coverage for those not now insured, many health policy experts have long argued for requiring employers to contribute to coverage for their workers. Such measures are known as "employer mandates" or, more recently, "shared responsibility" requirements on employers to help provide coverage. The health reform bills passed by both houses of Congress would require most large employers either to pay a share of the cost of their employees' coverage or to pay a fee to help subsidize coverage for the uninsured. An employer mandate has been endorsed by the world's largest retailer, Walmart; the nation's largest union federation, the AFL-CIO; and other groups.

Opposition to an employer mandate comes from at least three different directions. Some opponents of an employer mandate believe that employment-based insurance is an anachronism and should be replaced with a health insurance system that is more individual-oriented, portable, and in tune with the flexible and dynamic modern economy.

Others, such as the U.S. Chamber of Commerce, the National Federation of Independent Business, and a number of other business groups, oppose employer mandates for philosophical and practical reasons. They argue in particular that the burden of mandates falls on employers and would raise costs for many companies already harmed by the current economic downturn.

Others who don't want a mandate would prefer extending employment-based coverage with carrots as opposed to sticks. They favor such provisions as new tax incentives for smaller businesses to offer coverage.

## What's the background?

Employers began offering health coverage and other fringe benefits as a way to attract workers during World War II, when the federal government froze wages and prices to control wartime

inflation. Employers couldn't compete for workers by raising wages and salaries, so they added health insurance benefits instead. A major spur to employment-based coverage came in 1954, when U.S. tax authorities determined that health insurance benefits weren't taxable as income. As a result, workers don't have to pay federal income or payroll taxes on the contributions to health coverage that they receive from employers. This "tax exclusion" for employment-based health insurance and proposals for limiting it were explored in an earlier Health Policy Brief (see "Tax Debate," Health Policy Brief, July 9, 2009).

Today, employers offer health benefits both to recruit and retain workers and to improve workers' health status and productivity. As Paul Fronstin of the Employee Benefit Research Institute notes, employers also play a "watchdog" role, often advocating for workers during coverage disputes with insurers. Many employers also take an active role in improving the quality of health care and in helping employees select top-quality providers.

Employers can provide health coverage several ways. Smaller firms typically purchase actual insurance policies for their employees. Most large corporations "self-insure," which means that they pay employees' medical bills directly (although they typically contract with insurance companies for administrative services and "stop-loss" insurance coverage). Insurance policies purchased by

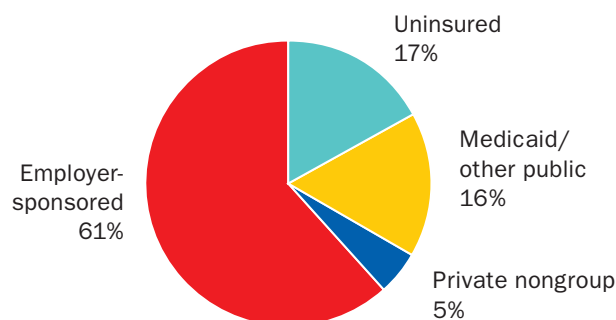
employers on behalf of their employees are regulated by the state in which the insurance was issued. Firms that self-insure are exempt from state regulation, but both insured and self-insured employer plans are regulated under a federal law called the Employee Retirement Income Security Act (ERISA) of 1974. ERISA requires that policies meet certain fiduciary, reporting, and disclosure standards and include consumer protections like an appeals procedure if a claim is denied.

Additional provisions of federal law also apply to employer-based health benefits. A 1985 law known as the Consolidated Omnibus Budget Reconciliation Act (COBRA) and a 1996 law, the Health Insurance Portability and Accountability Act (HIPAA), added such requirements as allowing workers to continue their coverage if they leave or change jobs; limiting exclusions for pre-existing conditions; and setting privacy protections for electronic medical information.

**Coverage by firm size:** By and large, most large firms in the United States offer coverage to some or all of their workers. In 2009, 98 percent of firms with 200 or more employees offered benefits, according to a survey by the Kaiser Family Foundation and the Health Research and Educational Trust (HRET). These employers contributed an average of 77 percent of the \$13,704 cost of a family policy and 82 percent of the \$4,876 cost of individual coverage.

#### EXHIBIT 1

### Health Insurance Coverage of the U.S. Nonelderly Population, 2007



Total = 261.4 million people

Source: Kaiser Commission on Medicaid and the Uninsured/Urban Institute analysis of data from the 2008 Annual Social and Economic Supplement, Current Population Survey.

Note: Medicaid/other public includes Medicaid, CHIP, other state programs, Medicare (for the nonelderly), and military-related coverage. Data might not add to 100% because of rounding.

### Percentage of firms offering health coverage varies by company size (2009)

Fewer than 10 employees: **46%**

3–199 employees: **59%**

200 or more employees: **98%**

Source: Kaiser Family Foundation and Health Research and Educational Trust, 2009

Employment-based coverage is less common among smaller firms and has been shrinking in recent years. The 2009 Kaiser-HRET survey found that since 1999, the number of firms with 3–199 workers offering coverage to workers fell by six percentage points — from 65 percent to 59 percent. For employers with fewer than 10 workers, those offering coverage fell by ten percentage points — from 56 percent to 46 percent. Yet during the same time period, employer-sponsored coverage remained relatively stable for employers with 200 or more employees. Economist Elise Gould has described the overall loss this way: After accounting for population growth, as many as fourteen million more people under age 65 would have had employment-sponsored health insurance in 2007 if the coverage rate had remained at the 2000 level.

A major reason for the decline is cost. From 1999 to 2009, the Kaiser-HRET survey indicates, average premiums more than doubled, from \$2,196 to \$4,824 for single coverage, and from \$5,791 to \$13,375 for family coverage. Premiums have grown three times as fast as workers' earnings and three and a half times as fast as inflation. Even in instances where employers have continued to offer coverage, lower-income workers may not participate, often because of required employee contributions to premiums. In 2005, 30 percent of uninsured workers had access to employer coverage through their own job or through a family member.

**History of mandate proposals:** With employment-based coverage having been so dominant in the United States for so long, there have been periodic proposals to extend coverage even further through mandates on employers to contribute to health insurance. The State of Hawaii enacted an employer mandate in 1974. That same year, President Richard Nixon proposed a mandate at the national level, as did President Bill Clinton in 1993. In neither case, though, was a mandate proposal passed by Congress.

In 2007 and 2008, employer mandates were features of health reform plans put forward by several U.S. presidential candidates, including Sens. Hillary Clinton and Barack Obama.

Central to the debate over employer mandates over the years has been discussion of who — the employer or the employee — actually bears the cost of mandates. Even though employers con-

tribute the money toward health coverage for their workers, economic theory and some real-world evidence suggest that active employees actually bear the cost. This is because firms make decisions to hire and pay workers based on the total compensation package — wages and salaries plus the value of all benefits, including sick and vacation leave as well as health and disability insurance. If they offer more in benefits, either voluntarily or because it's mandated that they do so, they will offer less in wages and salaries.

According to this line of analysis, if employers are mandated to offer health benefits, they will adjust wages and salaries downward, or at least slow their growth, to compensate. This adjustment, in the long run, will limit the cost of a mandate to employers. An exception may be companies that pay at or near the minimum wage and offer no fringe benefits. They may have little if any room to adjust wages downward and, in worst-case scenarios, may be forced to cut jobs.

As is often the case in economics, there is some disagreement over whether workers bear the full cost of health benefits and whether or not employers are immune. For an analysis showing that some economists have found that employers may also bear some costs, see the article by Neeraj Sood and colleagues listed in the Resources section below.

### What's proposed?

The legislative health reform proposals that have passed the House of Representatives and the Senate contain variants of what is known as a “play-or-pay” approach. A large employer would have to “play” — offer health coverage that met specified standards and make a substantial contribution toward premiums — or pay an assessment. Workers at an employer that did not provide coverage would be able to buy coverage through a new purchasing arrangement known as an insurance exchange, and those with family incomes below 400 percent of the poverty level could receive federal subsidies to help pay their premiums for coverage through the exchange.

Workers at firms that did meet the coverage and premium contribution requirements could still leave the employer group and obtain coverage through the exchange or elsewhere. However, they would have to pay the premiums on their

Full-time workers  
without health  
insurance in 2007:

**21 million**

Part-time workers  
without health  
insurance in 2007:

**5.8 million**

Source: U.S. Census  
Bureau, Current  
Population Survey.

own; they could not receive subsidies for exchange coverage unless their costs for the employer plan would exceed a specified threshold.

While both bills follow this general approach, they differ in many details, as follows.

**House of Representatives:** Under the House bill, HR 3962 (Affordable Health Care for America Act), employers would have to provide coverage that included a defined “essential benefits” package beginning in 2013. (Under a grandfather clause, employers could continue to offer existing plans that failed to meet the benefit standard for five years.) Employers would have to pay at least 72.5 percent of the premium for the lowest-cost health insurance plan offered to individual full-time employees and 65 percent of the lowest-cost plan available to cover a full-time employee’s dependents. (The definition of who is a full-time employee is to be left to federal regulators to decide.)

Employers choosing to “pay” — not to offer coverage — would have to pay a percentage of their payroll, starting at 2 percent for firms with annual payrolls between \$500,000 and \$585,000 and rising to 8 percent for firms with annual payrolls above \$750,000. (In comparison, employers who offered health benefits in 2005 spent a median of 11 percent of payroll for those benefits.) These sums would be paid into a new Health Insurance Exchange Trust Fund that would in turn make “affordability credits” available to help uninsured people buy health coverage.

Employers who offered coverage would be required to automatically enroll employees in the lowest-cost available plan, but employees would be permitted to opt out of the employer plan and obtain coverage through the insurance exchange or elsewhere. However, a worker who refused employer coverage could obtain an affordability credit for exchange coverage only if he or she would have had to pay more than 12 percent of income to buy into the employer plan.

**Senate:** The Senate bill, the Patient Protection and Affordable Care Act (passed as an amendment to HR 3590) includes play-or-pay requirements for firms with 50 or more full-time workers, defined as those working at least 30 hours a week. (Construction firms are subject to the requirements if they have five full-time employees and an annual payroll of \$250,000.) There would be a complicated scheme of required payments linked

to employees’ participation in subsidized non-employer coverage through the insurance exchange.

- If the employer did not offer “minimum essential coverage” (defined as coverage that paid 60 percent of the cost of covered services) to its full-time employees, the employees could obtain coverage through the insurance exchange. In this case, employees who joined the exchange and who had incomes below 400 percent of poverty would be eligible for premium and cost-sharing subsidies. If any one employee obtained the subsidies, the employer would have to pay \$750 a year for every full-time employee (whether or not the rest obtained subsidized coverage). This amount would increase each year in proportion to the increase in the average national health insurance premium.
- If the employer offered coverage, but a given employee had to pay more than 9.8 percent of income to participate in the coverage, the employee could decline the employer coverage and get subsidized coverage through the exchange. The employer would have to pay the lesser of \$3,000 a year times the number of employees with subsidized exchange coverage, or \$750 per year times its total number of full-time employees.
- If the employee had to pay between 8 and 9.8 percent of income for the employer plan, the employee could choose to join the exchange, and the employer would have to give the employee a “free choice voucher” equal to what the employer would have contributed toward the employer plan. The employee could apply the voucher toward the premium for exchange; if the voucher was more than the premium, the employee could pocket the difference.

The bill includes a requirement that firms with more than 200 employees automatically enroll in available coverage. As in the House bill, employees could opt out. Both the House and Senate bills include temporary financial assistance for smaller or low-payroll employers newly offering coverage. However, there is minimal overlap between the set of firms eligible for these subsidies and the set subject to the play-or-pay requirements.

The differences in the size and applicability of financial penalties under the House and Senate bills reflect a basic difference in the goals of the

play-or-pay provisions. The House provisions apply to more employers and include higher assessments. The Congressional Budget Office (CBO) estimates that 7 million people would ultimately gain employer coverage—an increase of 4 percent—and that payments by employers who did not provide coverage would come to \$135 billion over the years 2013-2019.

Under the Senate bill, on the other hand, most of the employers subject to the play-or-pay requirements are already offering health benefits (although they may be contributing less than the required share of premiums). CBO estimates that over time there would be actually be a slight reduction in the number of people with employer coverage, as some workers shifted to the insurance exchanges. The aim of the Senate provision is to prevent more of these shifts, an issue to be considered in the next section.

### What's the argument?

**In favor of an employer mandate:** Supporters argue that expanding employer-based health insurance through mandates would have several advantages. The approach would build on existing employment-based group health insurance, which provides coverage to the majority of insured Americans. This type of coverage is typically a good deal for most workers because administrative costs are usually lower than those for individual insurance coverage.

Employment-based coverage is also an effective way to “pool risk,” so that the higher costs of covering sicker workers are spread across healthier ones. In the individual market, healthier people are less likely to seek coverage. In employer groups, healthier people are more likely to participate, because of ease of enrollment and employer-subsidized premiums. Some of these advantages might diminish in the context of a health reform proposal that provides easier routes to coverage and public premium subsidies. Nevertheless, the lower administrative costs of group coverage would still make it a relative bargain.

In addition to the employer mandate, supporters of expanding employment-based coverage point to other legislative provisions of the main House and Senate bills that would level the playing field for smaller versus larger firms. Currently, smaller firms buying coverage for their workers

may have to pay high fees to insurance agents, or high administrative fees to insurers, to obtain coverage for their workers. This means that small businesses may now pay as much as 18 percent more than large companies pay for the same health insurance policy. These costs can erode profits and can be passed on to workers in the form of lower wages or less generous health benefits.

But once the exchanges were up and running, employees whose firms did not offer coverage could obtain insurance through them. In effect, those workers would then be eligible for “pooled,” lower-cost health insurance and standardized benefit packages and would receive better coverage than they typically now receive.

Although there are concerns that an employer mandate would reduce employment overall, the CBO as well as most economists generally agree that the effect on overall employment would not be large. Several studies on the effects of play-or-pay requirements have thus projected the loss of anywhere from 224,000 to 750,000 jobs—in the end, a very small proportion of jobs in an economy that currently employs about 140 million people.

**Dealing with “crowding-out”:** One goal of the employer mandates in the current legislative proposals is not to expand access to employer coverage, but to prevent its erosion. Comparatively few workers would actually gain employer coverage as a result of the new rules, especially under the Senate bill. However, the proposals would also provide substantial tax subsidies for many lower-income individuals buying coverage on their own through the new insurance exchanges.

In the absence of the mandate (and the related requirements making people with access to adequate employer coverage ineligible for subsidies), individual employees might find it advantageous to shift from their employer plan to subsidized exchange coverage. Firms with many subsidy-eligible workers might drop coverage altogether, perhaps replacing health benefits with higher wages or other fringe benefits.

The possible replacement of employer dollars with public subsidy dollars is often known as “crowding out.”

The potential effects are suggested by a CBO analysis of an early version of the health reform proposal developed by the Senate HELP Committee. This proposal initially had generous subsidies

for individuals and no play-or-pay requirement. CBO estimated that 15 million people would shift from employer plans to subsidized exchange coverage; these people would have accounted for a substantial share of the new federal spending in the bill. Once the bill was modified to include a play-or-pay rule, CBO estimated that it would have no net effect on employer coverage. The key role of the mandate, then, is to reduce the likelihood that health reform would shift spending from employers to the federal budget.

Supporters of a broad employer mandate object to the feature of the Senate proposal that ties employer penalties to the number of employees receiving income-based premium subsidies. A recent study from the Center on Budget and Policy Priorities points out that charging fees for only some employees could distort hiring decisions, creating an incentive for employers to avoid hiring workers likely to qualify for these subsidies. Provisions in health reform legislation to prohibit discriminatory hiring practices would be difficult to enforce, the study concludes.

**Against an employer mandate:** Opponents of an employer mandate, such as the U.S. Chamber of Commerce and the National Federation of Independent Business (NFIB), underscore the concern that it could lead to job losses — especially now, in a recession. They also point to the rising cost of health insurance, noting that from 2001 to 2008, premiums increased as much as 75 percent for individual employees and 80 percent for families. They say that many businesses newly forced to contribute to health coverage for workers simply could not shoulder these rapidly rising costs. And they doubt that the other health reforms Congress and President Obama propose, such as creation of health insurance exchanges and pooling, will actually make health insurance more affordable for small businesses.

A recent report by the NFIB, the nation's largest small-business organization, suggested that the toll would be higher than has been borne out by other economic research. The report said that an average of roughly 320,000 jobs would be lost for each of the first five years after an employer mandate was implemented, with a corresponding \$200 billion reduction in gross domestic product over the entire period. However, the report assumed that all employers, regardless of size

or payroll, would have to pay 50 percent of employees' premiums. Such a requirement would be more burdensome for more employers than those imposed by the current legislative proposals.

Whatever the effect on overall employment, there is also a possibility that requirements applicable only to full-time employees, however these are defined, could simply lead employers to reduce some workers' hours. Another concern, expressed in a recent article by Bradley Herring and Mark V. Pauly, is that lower-wage workers in firms that provided coverage could actually be left worse off than those in the firms that chose to pay a penalty. The net subsidy provided by their employer would often be less than they could have obtained through the exchange. One suggested solution would be to provide the same total subsidy to people at a given income level, regardless of where they obtained coverage.

Critics also object to some technical aspects of the employer mandates under consideration. Play-or-pay formulas based on a specific share of the company's payroll, or a mandate based on a particular firm's workforce size, wouldn't take into account geographic differences in medical and health insurance costs, or variations in payroll or size by type of industry. The NFIB complains, moreover, that a small business would have to pay taxes based on a share of payroll regardless of whether or not the firm was profitable.

Finally, there is concern about congressional efforts to create "standardized" benefit packages. These could become so generous, mandate opponents say, that even a mandated partial contribution toward the costs would be unaffordable for many firms. (An excessively expensive minimum benefit package worries not just people concerned about an employer mandate, but also people concerned about an individual mandate that would require individuals to buy coverage.)

### What's next?

As this brief is published, congressional leaders are attempting to reconcile the differences in the bills passed by the House and Senate. It is not yet clear whether what emerges from the next stages of the process will be similar to or different from either of the proposals discussed in this brief.

## Resources

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### About Health Policy Briefs

Written by  
**Mark Merlis**  
Health Policy Consultant

**Susan Dentzer**  
Editor-in-Chief, *Health Affairs*

Editorial review by  
**Paul Fronstin**  
Director, Health Research &  
Education Program  
Employee Benefit Research  
Institute

**Elise Gould**  
Director of Health Policy Research  
Economic Policy Institute

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