

## EMPLOYER-SPONSORED HEALTH INSURANCE AND THE PROMISE OF HEALTH INSURANCE REFORM

Employer-sponsored health insurance (ESI) has long been the mainstay of coverage in the U.S. As we face the prospect of another round of debate over health care reform, there is a fundamental difference of opinion over what role employers should play in a reformed system. Employers are central to some reform proposals, such as those built around a mandate on employers to provide insurance. Other proposals – for example, the individual tax credit - establish incentives that would, over time, weaken the link between employment and insurance. As we debate different options for reform, one question that must be addressed is whether we should shore up the system of employer-sponsored health insurance or whether, on the other hand, it may be time to move away from this system.

Economists Tom Buchmueller of the University of Michigan and Alan Monheit of the University of Medicine and Dentistry of New Jersey discuss how we arrived at an employment-based system and the efficiency gains and losses of keeping it. They note that the spread of ESI in the U.S. was encouraged by a number of historical events. For example, health benefits were exempt from the wage and price freeze of 1942, which led employers to provide health insurance as a way to attract and retain workers in a tight labor market. In 1954, the Internal Revenue Service confirmed that health insurance benefits provided by employers were excluded from an individual's taxable income (as they continue to be), which made ESI relatively less expensive. Today, about 90 percent of all private health insurance is provided through employer groups.

Buchmueller and Monheit summarize the pros and cons of the link between employment and health insurance as follows:

### PROS

- **Economies of scale:** having one large purchaser reduces the average fixed cost of buying insurance
- **Risk pooling:** adverse selection problems are mitigated in the large group insurance market

### CONS

- **Unfairness:** system works better for large than small firms; and people not in the labor force, or seasonal workers, can be left out altogether
- **Distortions in the labor market:** reduced mobility of labor (“job lock”); incentive to shift to part-time workers
- **Extra costs of labor market transitions** for those who have many transitions

Buchmueller and Monheit provide a conceptual framework for evaluating the impact on ESI of different approaches to health reform. They note that ultimately, the decision of whether or not employers should retain their central role in providing health insurance rests with the voters, who decide what incentives, if any, employers and individuals should face for obtaining coverage from one source rather than another. To date, voters have decided to build on the existing system

of ESI rather than replace it. In response, Buchmueller and Monheit discuss three issues that should be considered in any reform proposal: portability, greater equity and efficiency of ESI through a modification of the regressive tax deduction of such coverage, and improved access for small employers to affordable health insurance.