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'Competition' among employers offering health insurance

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Abstract

Most employees contribute towards the cost of employer-sponsored insurance, despite tax laws that favor zero contributions. Contribution levels vary markedly across firms, and the average contribution (as a percentage of the premium) has increased over time. We offer a novel explanation for these facts: employers raise contribution levels to encourage their employees to obtain coverage from their spouses' employer. We develop a model to show how the employee contribution required by a given firm depends on characteristics of the firm and its work force, and find empirical support for many of the model's predictions.

JEL classification: I11; J33

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1. Introduction

Since the 1950s, most Americans under 65 have obtained health insurance through their employers (Employee Benefit Retirement Institute, 1995). While it is commonplace today for workers and employers to contribute jointly towards the

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cost of these plans, there is tremendous variation in these contributions across firms. [1] While some firms continue to pay the entire cost of insurance, others require contributions towards individual coverage of US$500 or more, and contributions towards family coverage of US$2500 or more. There has also been an increase in employee contributions over time. As recently as 1980, the majority of employers bore the entire cost of health insurance (Employee Benefit Retirement Institute, 1995).

We argue that these patterns of health insurance contributions may be driven, at least in part, by the presence of two-career couples and employer competition to be the 'employer not chosen' for insurance. We present a model in which competitive forces lead employers to raise contributions to encourage their workers to switch plans and obtain insurance from their spouses' employers instead. [2] We show that the equilibrium employee contribution is sensitive to several critical factors, including the cost of insurance, the percentage of two-career couples, the income tax rate, and the heterogeneity of plans and employee preferences. Using data from the Robert Wood Johnson Foundation Employer Health Insurance Survey, we find empirical support for several key predictions of our model.

Our analysis is motivated by a fundamental difference that exists between health insurance and other employee benefits. Namely, family health insurance benefits obtained by different members of a household generally substitute for one another, whereas pensions, life insurance, and other benefits obtained by different members of a household generally augment one another. The implication is that firms can reduce their health insurance costs without necessarily reducing the well-being of their employees by encouraging them to obtain coverage from their spouses' employers.

Although we have heard numerous anecdotes supporting our explanation for why employers require employees to make contributions towards health insurance, we have seen no discussion of it in the literature. Morrisey et al. (1994) note that small employers require larger contributions than do large employers but offer no explanation for either the imposition of contributions or the differential. They also report that insurance offered by small employers is less generous on other dimensions besides contribution levels. While our model focuses on contributions, the intuitions that we draw should apply to these other dimensions as well. That is, firms may reduce the generosity of insurance so as to encourage their employees to select their spouse's plans. The savings would offset the foregone tax benefits of providing more generous insurance to those workers who do not switch plans.

[1] Using data from the Robert Wood Johnson Foundation Employer Health Insurance Survey, we find that the coefficient of variation of contributions towards family plans is approximately 0.75.

[2] Increasing contributions for individual coverage will have the same effect if the employee has another source of coverage, such as a spouse with family coverage.