

Health insurance market reform and employee compensation: The case of pure community rating in New York[☆]

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Abstract

Pure community rating, which was enacted to improve access to health insurance in New York's small group market in 1993, prevents carriers from charging different premiums based on the ages of a firm's workers. If small firms were adjusting compensation packages prior to reform to offset higher health care costs of older workers, then community rating could lead to greater relative wages for older workers post reform and not necessarily induce adverse selection that results in changes in who is insured. I present evidence showing that relative wages of older workers in small firms increased in comparison with other states and with large firms within New York following reform.

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1. Introduction

Health care costs have risen substantially since 2000 after a short period in the mid and late 1990s when the rise in costs stalled.¹ Debate over how best to reform health care delivery has

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¹ For a thorough review of trends in health care costs and employer premiums, see the Kaiser Family Foundation's Health Care Marketplace Project at: <http://www.kff.org/about/marketplace.cfm>.

likewise picked up steam. Of particular concern are the costs faced by small businesses in providing health care to workers. This paper uses the case of health insurance market reform in New York to test whether legislated changes in the small group market affect how firms compensate workers. In the process, it provides insights into whether wages are altered to offset the costs of health insurance. If they are, some market reforms may lead to changes in wages but not necessarily induce adverse selection that results in changes in who is insured.

New York enacted premium reform in their small group market in 1993. After 1993, insurance companies were no longer able to vary premiums on the basis of individual risk factors such as age. They could only use geographic location to set premiums. Pure community rating differs remarkably from the prior policy regime of underwriting, where specific employee characteristics were used to set the premium for the group. Other research (Buchmueller and DiNardo, 2002) found no detectable relative impact on insurance coverage in New York following reform. One potential explanation is that firms were able to alter compensation packages to adjust to the reform, thus avoiding the feared adverse selection that a reform like pure community rating could create. This would be true if firms had been offsetting the differing costs of health insurance with wage differences prior to reform. Following passage of pure community rating in New York, I observe whether or not small firms increased the wages of their older workers (relative to younger workers) because the relative cost of insuring them fell. As a test of whether such changes were the result of the reform and not some other concurrent change in New York, I compare changes in small firms with changes over the same period in large firms. I also use small firms in other states as a comparison group. Both large firms in New York and firms in other states were not subject to pure community rating. The results indicate that the wage gap between older and younger workers grew following reform in comparison with both control groups.

The paper is a contribution to three important lines of research. First, it helps in the understanding of how reforming the health care system through altering the costs faced by employers could directly influence on how firms compensate workers. Second, given that other estimates have shown that insurance coverage at small firms in New York did not change after reform, it provides evidence consistent with a tradeoff of wages and fringe benefits. This is a finding that has been difficult to show in the empirical literature due to worker and firm heterogeneity. Finally, it provides information about the role of non-wage benefits in age-compensation profiles. The next section discusses some of the background, both conceptual and empirical, for each of these lines of research. In subsequent sections, I describe the data, outline the empirical approach, and present the results.

2. Background and existing evidence

2.1. Pure community rating in New York

Pure community rating was enacted in New York as part of a series of reforms targeting the small group health insurance market, most notably to combat the impact of insurer underwriting. New York was not unique with regard to many of its measures, including provisions to increase health insurance portability by limiting the extent to which workers could be denied coverage based on pre-existing conditions and mandates guaranteeing issue and renewal of health insurance with no weight placed on risk.²

² The General Accounting Office (1996) produced a report that details the small group health insurance reforms that were passed in New York and other states during the time of the sample period used in this study.

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