



Premium copayments and the trade-off between wages and employer-provided health insurance



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ABSTRACT

This paper estimates the trade-off between salary and health insurance costs using data on Illinois school teachers between 1991 and 2008 that allow us to address several common empirical challenges in this literature. Teachers paid about 17 percent of the cost of individual health insurance and about 46 percent of the cost of their family members' plans through premium contributions, but we find no evidence that teachers' salaries respond to changes in insurance costs. Consistent with a higher willingness to pay for insurance, we find that premium contributions are higher in districts that employ a higher-tenured workforce. We find no evidence that school districts respond to higher health insurance costs by reducing the number of teachers.

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1. Introduction

One of the most pressing issues that continues to confront policy-makers, employers and individuals is that the growth in health care costs have exceeded the growth of per capita incomes, wages, and the price of other goods for several decades. In 1960 annual per capita health spending was \$809 (in 2009 dollars) and by 2009 it had increased to \$7375, for an average annual growth rate of 4.6 percent (Chernew and Newhouse, 2011). Over this same period, inflation-adjusted per capita income increased by 1.8 percent.¹ This large and persistent growth in health care spending was an important issue in the debate over the Affordable Care Act and is a top concern for employers and workers because the vast majority of the under-65 population who have health insurance

coverage receive their coverage as part of an employee compensation package. The growth in health care costs is also central to the long-term prospects for the federal and state government budgets through its effects on the cost of publically-provided insurance and on the costs to provide health insurance to public-sector workers. This paper investigates the incidence of rising health insurance premiums using a unique data set from over 600 public school districts in Illinois that tracks wages, health insurance premiums, and employee premium copayments for public school teachers from 1990–91 through the 2007–2008 school years.

While employer-provided health insurance premiums and total employment costs have been rising steadily over the last half-century, employees' monetary compensation has remained relatively flat. Economists traditionally interpret the disparity in these trends as partially reflecting an implicit (and sometimes explicit) trade-off that employees make between salary, other forms of compensation, and job attributes more generally. As health insurance costs increase, employees are increasingly willing to accept slower wage growth to maintain their health benefits. A long line of empirical research, however, has failed to find clear evidence that health insurance costs are borne by employees, which calls into question the long-standing views most economists hold about the incidence of rising health insurance costs and, more generally,

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¹ Per capita personal income in 1960 was \$14,651 (in 2009 dollars) and in 2009 was \$35,115. Data on personal income is from the Bureau of Economic Analysis National Income and Product Accounts. Data on the Consumer Price Index is from the Bureau of Labor Statistics.

whether the labor market operates as a sorting mechanism based on employer and employee preferences for employer-provided health benefits.²

This paper estimates the trade-off between salary and health insurance costs using a unique data source on salary and benefits provided to public school teachers in over 600 schools districts in Illinois between 1991 and 2008. Public school teachers are an interesting and important group to study: there is a widely-held belief that public-sector employees receive higher compensation than what they would earn in the private-sector and much of the disparity is driven by differences in employee benefits. Recent attempts in Wisconsin and Ohio to restrict collective bargaining by public-sector employees were predicated, in part, on the desire to reduce compensation costs in general and employee benefit costs in particular. A similar debate is going on Illinois, where there are policy proposals to alter collective bargaining rules on a number of dimensions and also reduce the value of pensions for public-sector workers. These debates generally ignore the possibility that salaries and benefits are jointly determined, so attempts to reduce benefit costs will generally put upward pressure on salaries to maintain the same quality workforce.

Illinois public school teachers are also interesting to study because we have an almost ideal dataset to examine the trade-off between salary and benefits and can address some of the empirical limitations that have plagued past work. The salary survey that we use includes information on the premiums for individual and family health insurance plans and the fraction of the premium that is paid by the teacher through regular salary deductions. For the sake the brevity, we refer to these teacher contributions to health insurance premiums as “premium copayments”. These premium copayments are important and have not been well-studied in the literature. According to nationally-representative survey data compiled by the Kaiser Family Foundation, 84 percent of workers covered by employer-provided insurance paid a premium copayment for their individual insurance in 2011, up from 76 percent in 2002.³ These premium copayments accounted for 18 percent of the premium for individual coverage in 2011 and 28 percent of the premium for family coverage.⁴ Our data on Illinois school district compensation contracts thus allows us to directly measure the correlation between changes in total insurance premiums, salaries, and premium copayments.

Economic theory offers a clear prediction about the relationship between wages, health insurance costs, and total compensation. When both employees and firms are willing to substitute insurance (and other benefits) for some of their salary, exogenous changes in the cost of benefits will be offset by changes in salary, leaving total compensation unaffected. This is true both in a competitive spot labor market, where the labor market serves as a sorting device to match workers and firms who share a preferred mix of salary and benefits, as well as in a union-management or union-government negotiation, which is the case we study. In union-management contract negotiations, management is concerned about the total compensation an employee receives and how the mix of wages and benefits affects workforce quality; unions will negotiate a compensation level and mix that a majority of members will support.

A long line of research, however, has been largely unsuccessful in estimating a meaningful trade-off between health insurance and wages.

Data problems, as opposed to poor theory, have been the primary reason offered to explain why it has been difficult to empirically measure wage offsets from rising health insurance costs. One frequently cited reason for the lack of empirical support is that typical data sources have poor measures of individual productivity. An OLS regression often finds a positive association between wages and health insurance, which simply reflects the fact that higher skilled workers tend to receive both high wages and more benefits. It is exceedingly difficult to adequately control for individual productivity and remove this omitted variables bias. A second reason is that data on employee premium copayments are not part of many datasets used to study the wage-health insurance trade-off. Thus, to the extent that adjustments occur through premium copayments, the relationship between gross compensation and the level of health insurance benefits will understate the overall relationship between wages and insurance premiums.

Our analysis indicates that total health insurance costs rose for Illinois teachers at the same rate as they did nationally. Rising premium costs were partially offset by rising teacher premium copayments; teachers paid about 17 cents in higher premium copayments for each dollar increase in the cost of individual health insurance and about a 46 cent premium copayment increase for each dollar increase in the cost of family coverage. Offsets through premium copayments are larger in districts that have longer-tenured (thus older) teachers: a one-year rightward shift in the teacher tenure distribution increases the teacher premium copayment by an additional 3 cents for each dollar increase in premiums. Premium copayments do not, however, cover the full cost of health insurance, leaving ample room for additional offsets on other margins or for some of the incidence to fall on districts. We find no evidence that changes in teachers' salaries within a district over time are related to changes in insurance premiums. We also find no evidence that rising health insurance premiums reduce districts' demand for teachers or that districts substitute less-experienced teachers when health costs rise. Our results are strikingly similar to those of Anand (2011), who uses the National Compensation Survey to study this trade-off using nationally representative data. Our results are also consistent with Clemens and Cutler (2014), who find a small but statistically insignificant salary offset in response to predicted changes in the cost of health insurance among school districts nationally. This congruence of results gives us confidence that we have, in fact, found an empirical pattern that is real and is not unique to the particular employment setting that we study.

We draw two conclusions from these results. First, take-home compensation adjusts to rising premium costs, though all of the adjustment comes through premium copayments and not through negotiated salary levels. Our results suggest that school districts bear some of the incidence of rising health insurance premiums, especially for individual insurance. But we cannot rule out that measurement error in premiums leads us to understate the share borne by teachers. Second, the premium offset is significantly larger in districts with an older workforce is consistent with older workers placing a higher value on the health benefits associated with higher premiums.

2. The relationships between health insurance premiums, wages and employee premium contributions

The starting point for understanding how wages and premiums respond to changes in health insurance premiums begins with the model used to explain differences in wages and health insurance premiums across employers at a point in time. Goldstein and Pauly

² See Currie and Madrian (1999) and our discussion in Section 2.

³ Kaiser Family Foundation and Health Research and Educational Trust (2011). These data refer to private-sector and public-sector employees, excluding employees of the federal government.

⁴ The National Compensation Survey conducted by the BLS for 2011 found that among all civilian employees with employer provided health benefits, employees paid for 21 percent of the cost of individual coverage and 33 percent of the cost of family coverage through premium copayments that were deducted from a worker's pay check. See BLS series NBU11500000000000031175 and NBU11500000000000031177 at <http://www.bls.gov/ncs/>.

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