Pay or Play:
Yes, It's a Threat

BRIEFLY

The pay or play system of health insurance would impose a substantial payroll tax on some state businesses, raising their costs and hurting the overall competitiveness of the state's economy.

Our simulations show that pay or play would reduce employment in the state by 9,000 in 2010 and nearly 17,000 in 2015.

Those earning the minimum wage are the most likely to lose their jobs.

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The legislature is considering bills that would establish a "pay or play" system with respect to employer-provided health insurance. Businesses would be taxed (pay) to support the state's basic health plan if they did not provide employees a rich plate of health care benefits (play). Under these plans, employers with more than 50 employees would be liable for a substantial fee for each employee. The state would credit against the fee whatever the employer paid towards employee health care, so that if the employer spent enough on health care, no net fee would be due.

The state Health Care Authority estimates the monthly fee in 2006 for an employee working 20 or more hours a week would be $187. This is a substantial payroll tax. Even though many employers spend a sufficient amount on health care to avoid liability, the fee will place a significant drag on the state's economy. We estimate it could reduce employment in Washington by 9,000 in 2010 and nearly 17,000 in 2015.

The pay or play plan, termed the Health Care Responsibility Act by its authors, was introduced early in the session in both the House of Representatives and the Senate (HB 1702 and SB 5637). The House version was passed by the House Health Care Committee and is now at the House Appropriations Committee. The Senate version was amended and passed (as SSB 5673) by the Senate Health and Long-Term Care Committee and is now at the Senate Ways and Means Committee.

In this brief, we will focus primarily on the initial version of the bill, which survives as HB 1702, as this version has been the subject of a fiscal note prepared by the Office of Financial Management and the Health Care Authority and an analysis by the Economic Policy Institute.

BASIC HEALTH PLAN

The basic health plan (BHP) administered by the Health Care Authority (HCA) is a health insurance program that provides coverage to low income state residents. Premiums are subsidized, with the degree of subsidy varying with income. BHP began operation as a pilot program in 1988 and became permanent in 1993. The 2003 legislature placed a cap of 100,000 on subsidized enrollments. In addition to these 100,000 subsidized enrollees, about 1,400 state-funded home care workers receive health insurance through the BHP.

State law includes a provision allowing for a program of unsubsidized enrollments to the BHP. However, the unsubsidized program is currently dormant as no health care providers have been willing to bid for this business in recent years.

HB 1702

HB 1702 imposes fees on employers with 50 or more employees and creates three new programs to provide health insurance to certain workers. The bill also raises the minimum subsidy to be provided to current enrollees in the subsidized BHP.

Employer Fee. At the beginning of each year, the HCA administrator will determine an hourly fee in this manner: He will multiply the average monthly cost of providing BHP coverage to an adult by 0.85, add to this the per capita monthly cost of administering the programs established by HB 1702, and then divide the total by 86.

Every month, each employer with 50 or more workers will calculate a total number of hours worked by its employees subject to the fee. The number of hours counted for any single employee is capped at 86, and employees with less than three months tenure are excluded. The employer will then multiply this total number of hours by the hourly fee. From this gross obligation, the employer deducts the amount that it has paid to provide health insurance to employees. If the resulting net obligation is positive, the employer pays it to the state.

These fees will go into a new dedicated account, the basic health plan employer fee account.

Fee-supported BHP enrollees. The primary program established by the bill will create a new class of enrollees in the basic health plan, fee-supported enrollees. To be eligible, an individual must be an employee of an employer that has paid money into the employer fee account, must have worked for the employer for at least three months, must not be eligible for Medicare, and must work at least 86 hours per month. A fee-supported enrollee will pay a premium equal to 15 percent of the cost to the BHP of covering an individual.

Premium assistance program. The HCA administrator would accept applications to this program from individuals who work for small employers and who would qualify for the subsidized BHP based on their incomes. The program would provide premium assistance to enable employees to pay the employees' share in their employers' group health plans. The cost would need to be less than the subsidy that would be paid if the employees joined the BHP.

The intent is for the recipients of premium assistance not to supplant enrollment in the regular subsidized BHP, which is currently capped at 100,000. Enrollments will be accepted in this program only to the extent that appropriations for the BHP are sufficient to support more than 100,000 enrollees. HCA believes that this condition is unlikely to be met and that the program will not be implemented. (HCA 2005, page 6)

Small employer group program. Small employers would be able to seek group coverage for their employees under the BHP. To be eligible, 75 percent of the employees would have to have wages or salary at or below 200 percent of federal poverty level for a family of three. For employees meeting the guideline, the employer would pay 40 percent of the cost of coverage, the employee would pay 20 percent, and the BHP would pay 40 percent.

This program will be funded by any savings to the BHP that occur as a result of the conversion of subsidized BHP enrollees to fee-supported enrollees and would only operate if such savings were identified. HCA foresees no enrollments in these programs before FY 2008, at the earliest. (HCA 2005, page 7)

Minimum subsidy raised. The subsidized BHP allows individuals with income less than 200 percent of federal poverty level to purchase health insurance with a premium that depends on the level of income. Under current law, the maximum premium charged is 54 percent of the cost of providing coverage. (So that 46 percent is the minimum subsidy.) HB 1702 would reduce the maximum premium to 20 percent of the cost of providing coverage. (So that 80 percent would be the minimum subsidy.) As a result, HCA indicates that the state will need to spend an additional $10.5 million in 2007 to maintain 100,000 enrollees in the subsidized BHP. (HCA 2005, page 3)

SSB 5637

The substitute bill passed by the Senate Committee on Health and Long-Term Care, SSB 5637, featured three significant changes from the original bill: First, the employer fee was pegged to 80 percent of the average cost of providing BHP coverage to an adult, rather than 85 percent. Second, the premium to be paid by fee-supported enrollees is set at 20 percent of the cost of coverage, rather than 15 percent. Third, when calculating the total hours worked by employees for the purposes of determining the fee owed, employers may exclude those employees who have health care coverage through another employer, either directly or as a dependent.

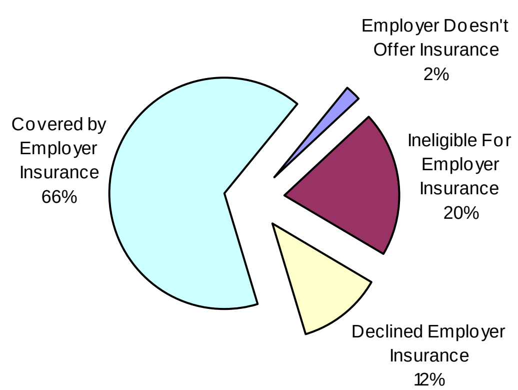
REVENUE FROM THE EMPLOYER FEE

Because we lack detailed information on employers' health care spending, it is difficult to forecast with confidence the revenue that would be raised by HB 1702's employer fee. The estimates of fee revenue prepared by the Employment Policy Institute (EPI) and HCA are wildly different, $1.594 billion by EPI and $49.7 million by HCA. (EPI 2005, page 8; HCA 2005, page 2)

The difficulty can be explained by examining results from the national survey of employer health benefits conducted in 2004 by the Kaiser Family Foundation and The Health Research and Education Trust (Kaiser/HRET).

Among the firms with 50 or more employees, the survey found that 98 percent of employees worked at firms that offered health insurance coverage to at least some of their employees. Of the employees of these firms, 80 percent were eligible for health benefits. Of these eligible workers, 85 percent elected to participate in their employers' plans. These results are summarized in Chart 1.

Chart 1: Insurance Status of Employees of Large Employers



Source: WRC calculations from Kaiser/HRET 2004 Survey

Of employees at firms with 50 or more employees, 66 percent received insurance coverage from their firms; 2 percent worked for firms that offered no coverage; 20 percent were ineligible for employer coverage; and 12 percent declined coverage offered to them.

The two major factors cited by Kaiser/HRET for worker ineligibility were waiting periods and minimum work hour rules. The two major factors cited for declining coverage were workers' unwillingness to pay their share of premiums and having coverage through a spouse (Kaiser/HRET, page 6).

Kaiser/HRET survey found that the average employer contribution for employees taking single coverage in 2004 was $261 per month, 84 percent of the cost of coverage. For employees taking family coverage, the average employer contribution was $607 per month, 72 percent of the cost. The survey, unfortunately, does not provide an average contribution across all covered employees. A Towers Perrin survey of 200 large employers pegged the average monthly employer contribution per insured employee for 2005 at $512.50, which was 79 percent of total cost, which is broadly consistent. (Kaiser/HRET 2004, page 75; Towers Perrin 2004)

HCA assumes that the employer fee will be $2.17 per hour, $187 per month for an employee working 86 or more hours. EPI uses a larger figure of $2.60 per hour, $224 per month. The EPI figure includes a 20 percent premium added to the subsidized BHP rate to cover the cost of maternity benefits, which are not covered by the subsidized basic health plan but will be covered for fee-supported enrollees. (The income limitations of the subsidized basic health plan are such that any enrollee who becomes pregnant qualifies for maternity benefits under Medicaid. The language of HB 1702 is ambiguous as to whether the fee is to be set based on the cost of serving subsidized enrollees or fee based enrollees.) HCA's actuaries indicate that even including maternity benefits, the per member per month cost of the fee-supported enrollees will be within one dollar of the cost of the subsidized enrollees.

If we assume that the distribution of employee insurance statuses shown in Chart 1 and the $512.50 per month per insured employee apply to Washington state, firms with 50 or more employees are spending $338 per month on health care for each employee (covered or not) in 2005. This is 81 percent more than the $187 per month HCA estimate of the full-time employee fee and 51 percent more than the $224 per employee per month EPI estimate.

Thus, in aggregate firms are spending enough on health care to completely offset the fee. However, not every firm insures as great a share of its employees as the average firm does, nor does every firm match the average firm's per employee contribution. Some firms will pay the fee. These firms will be those with high percentages of part-time workers or seasonal and temporary workers who do not qualify for benefits. They also will include firms where the contribution per covered employee is low and the number of employees who decline coverage is high.

Unfortunately, we lack the detailed information on the distribution of health care spending across firms to determine how much the state will actually collect from the fee. HCA estimates that HB 1702 will generate $49.7 million per year based on the assumption that only firms that do not offer insurance to their employees will pay the fee. This is an underestimate. EPI estimates that the fee will generate $1.594 billion assuming that employers will pay the fee on all hours by workers who they do not insure. This is an overestimate.

HOW MANY WILL TAKE UP FEE-SUPPORTED ENROLLMENT?

The Kaiser/HRET survey found that 34 percent of employees of employers with 50 or more employees do not obtain insurance through their employers. Twelve percent of employees had declined coverage offered by their employers. It is not clear that many of these people would take-up coverage in the fee-supported BHP if given the opportunity.

Twenty percent of employees were ineligible for the coverage that their employers did offer, primarily because they were new hires or worked part-time. It is not clear how many of these people will be eligible for the fee-supported BHP as the program excludes those who work fewer than 20 hours a week or have been employed for less than three months.

Finally, two percent of employees worked at firms that did not offer insurance. Firms that do not offer insurance have work forces that are disproportionately low-wage and part-time. Again, it is unclear that many of these workers will be both eligible for the fee-supported program and willing to take up coverage.

EPI calculates that enrolling every eligible employee would use only 26 percent of the fees collected from employers.

INTERACTION WITH THE MINIMUM WAGE

Payroll taxes like the fee that HB 1702 would impose on some employers generally get shifted back onto employees, reducing wages. In the case of a worker earning the minimum wage, such a shift cannot take place. Washington has the highest minimum wage in the country, $7.35 in 2005. For an employer who pays the fee, the cost of hiring a minimum wage worker is effectively shifted up by more than two dollars per hour for the first 86 hours worked per month. EPI calculates that the effect of this will be to reduce employment by workers at or near the minimum wage by 25,500.

Because the fee is paid only on the first 86 hours worked a month, employers will have a preference to hire minimum wage workers willing to work a full 40 hours per week over those who want to work fewer hours. The provision of SSB 5637 which exempts from the tax employees who are covered by other employment based insurance has a further perverse effect. If an employer fills a minimum wage job with a teenager from a middle-class family who is covered by a parent's employer-provided policy, there will be no fee. If instead, the employer fills that job with a teenager from a low income family covered by Medicaid, there will be a fee. The poor kid would thus be more expensive to hire.

SIMULATIONS WITH THE WRC/REMI MODEL

We have used the Washington Research Council/Regional Economic Modeling, Inc. (WRC/REMI) model of the Washington economy to simulate the impact of the HB 1702 on the state economy under a range of different assumptions. In each simulation we specify the total fee paid to the state in 2006. We then assume that in subsequent years fee collections increase at the rate total wages increase. The major uncertainty is with respect to the amount of fee that the state will collect in the initial year. We have simulated five values. At the low end we use the $49.7 million HCA estimate, at the high end we use the $1.594 billion EPI estimate. We also simulate intermediate values of $400 million, $800 million, and $1.2 billion.

This fee will increase business costs and so will have a depressing effect on economic activity. At the same time, however, the state's spending of the revenue will have a simulative effect. To isolate the impact of the fee, we run a stimulation at each level of fee assuming the revenue is not spent.

Table 1: Job Loss in 2010 Depending on Amount Collected from Employers and Share of Revenue Returned as Health Care Spending

Percent	Fees Paid By Employers in 2006 (millions)				
Paid Out	$ 49.7	$ 400.0	$ 800.0	$ 1,200.0	$ 1,593.9
0%	(1,450)	(11,660)	(23,240)	(34,740)	(45,980)
26%					(38,690)
100%	(570)	(4,580)	(9,120)	(13,590)	(17,950)

Source: WRC/REMI Model

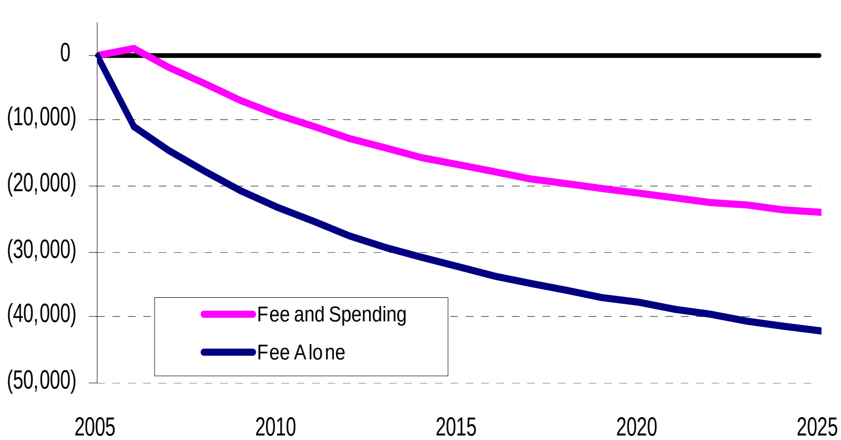
As HB 1702 is written, the money collected in fees can only be used to support BHP enrollments for qualified employees of employers who have paid fees in. It is possible (even likely) that that there will not be sufficient demand from qualified enrollees to fully exhaust the funds collected. (Under EPI's calculations, providing the BHP to all eligible employees would only use 26 percent of the funds collected.) We find it implausible, however, that the legislature would allow the money to go unspent; the excess funds would almost surely be used to fund other enrollments in the BHP. Thus for each of the fee levels we have a simulation where all of the proceeds are spent on health care.

In addition we have a simulation where fee revenue is at the level calculated by EPI and only 26 percent is paid out.

The simulations run from 2006 through 2025. Table 1 shows the impact of the bill on employment in 2010 for all eleven simulations. Looking across the simulations, the effect of the fee on job loss is approximately linear with each $1 million dollars in employer fees, measured in 2006, reducing 2010 employment by 29 jobs when the positive effect of spending the money is ignored and by 11 jobs when that effect is factored in.

At the high end, where the revenue raised by the fee in 2006 is $1.594 billion, the fee itself reduces 2010 employment by nearly 45,980, well in excess of the 25,500 near minimum wage jobs that EPI indicates will be lost. When 26 percent of the fee revenue is paid out, the job loss drops to 38,690, and when all the revenue is spent, the loss is 17,950.

Chart 2: Employment Impact when 2006 Fee is $800 Million



Source: WRC/REMI Model

At the low end, using the HCA's estimate that the fee will raise only $49.7 million in 2006, the job impact is much smaller, with the fee itself reducing 2010 employment by 1,450; factoring in the effect of the spending reduces the job loss to 570.

The actual result will lie somewhere between these two extremes. We find the $800 million scenario plausible.

Chart 2 graphs impact on employment for the two simulations where the fee raises $800 million in 2006. In the simulation where the revenue is not spent, the employer fee reduces employment by 10,950 in the first year, 2006, compared to the baseline simulation. The job loss grows over time, to 23,240 in 2010, 32,440 in 2015, and 37,810 in 2020. When the effect of increased spending on medical care is included, employment in 2006 is 970 greater than the baseline. Subsequent years show a loss of jobs compared to the baseline, with a net loss of 9,120 in 2010, 16,870 in 2015 and 21,040 in 2020. (The initial bump in jobs reflects the fact that the positive effect of the spending kicks in more quickly than the negative effect of the fee on business competitiveness.) Comparing for 2010 the simulation with the fee alone to that with both the fee and the spending, we see that the spending adds 14,120 jobs. Of these, 7,600 are in the health care sector.

DISCUSSION

The pay or play mandate would impose a substantial payroll tax on some Washington businesses. The businesses most likely to be affected are those who employ many low-skilled and part-time workers. For these low-income workers, the take-up rate for the fee-supported BHP is likely to be low.

The payroll tax will reduce the demand for labor. As a result some workers will find their wages lower than they would have been, while others will lose their jobs. Our preferred simulation indicates that there would be 9,000 fewer jobs in the state in 2010 and nearly 17,000 fewer jobs in 2015 under pay or play.

Those earning the minimum wage are the most likely to lose their jobs. In the end, they're the ones that pay.

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