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Employer Health Care Mandates: Taxing Low-Income Workers to Pay for Health Care

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Congressional advocates of the latest health care reform proposal claim that it will not cost ordinary Americans more—the costs will be borne by "the rich" and by employers. After all, both the House and the Senate versions require employers who do not provide health benefits to pay higher taxes.

But the Congressional Budget Office (CBO) recently reported what economists have long known: Regardless of who is formally required to pay, the burden of these taxes and costs will ultimately fall primarily on employees through lower wages. An employer mandate does not give workers without health insurance something for nothing but rather forces them to purchase it out of their wages whether they like it or not—and no matter how low those wages are. Congressional rhetoric to the contrary, much of the burden of paying for an employer mandate will fall on ordinary Americans, and lower-income workers will be hit the hardest.

Employer Mandates. Both the House and Senate drafts of health care reform include so-called "employer mandates" or "pay or play" provisions. These mandates require employers to pay higher taxes if (a) they do not offer health insurance, or (b) they offer it but have employees who decline it and instead use the government system.

The Senate version requires employers to pay $750 a year for each full-time employee without health coverage. The House version goes further, requiring most employers who do not provide health benefits (or whose employees decline it) to pay a penalty of 8 percent of their payroll. It has even been proposed that employers whose employees enroll in Medicaid may be required to pay this tax.

The ostensible purpose of such a tax penalty is to discourage employers from dropping workers onto the taxpayer-subsidized government plan. The tax will pay a portion of the public's costs when employees use the new government system instead of employer-sponsored insurance. However, the actual result will be lower pay and job losses, especially for low-income workers.

Costs Paid by Employees, Not Employers. Advocates of an employer mandate claim that employers and "the rich" will bear the burden of health coverage. However, the CBO recently reported that ordinary workers—not their employers—will ultimately bear the full cost of any reforms that make health insurance more expensive for employers.[1]

Although workers do not physically write a check for their health benefits, their employers write a smaller check to them every payday. Workers pay for health benefits through lower wages. As the CBO explains:

> Although employers directly pay most of the costs of their workers' health insurance, the available evidence indicates that active work-

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> ers—as a group—ultimately bear those costs. Employers' payments for health insurance are one form of compensation, along with wages, pension contributions, and other benefits. Firms decide how much labor to employ on the basis of the total cost of compensation and choose the composition of that compensation on the basis of what their workers generally prefer. Employers who offer to pay for health insurance thus pay less in wages and other forms of compensation than they otherwise would, keeping total compensation about the same. …
>
> [I]f employers who did not offer insurance were required to pay a fee, employees' wages and other forms of compensation would generally decline by the amount of that fee from what they would otherwise have been.[2]

Employers do not have limitless funds to dole out according to their own generosity. They must pay for all benefits and wages out of revenue received from customers; therefore they must decide how many employees to hire, and what to pay, based on the total cost of having that employee (and that employee's productivity). It does not matter from the employer's point of view how compensation is divided between wages, benefits, and payroll or other taxes.

If Congress makes health coverage more expensive for employers, or requires new payroll taxes, employers will be forced to cut wages to make up the difference. Even if the law stated (as the House bill does[3]) that employers could not cut pay directly to make up for the cost of health care, they will ultimately, somehow have to do just that.

For example, they could give smaller raises (too small to keep pace with inflation), less frequent promotions, lower starting pay to new employees, and/or wage cuts due to "the recession" until their total costs of employing a worker had fallen by nearly the same amount as the employer mandate imposed by Congress.[4]

No Free Lunch. An employer mandate does not give workers without health coverage a "free lunch": They will not be able to keep their current wages and benefits and have health care added to it at their employers' expense. Instead, the proposed laws would effectively force them to purchase health insurance and therefore spend less on other goods. Some workers will prefer this arrangement, but many others will not. In essence, the Congress would be telling the poor: "If you now have to choose between food and health insurance, you no longer have that choice—from now on you have to buy the health insurance."

Wage Cuts for Low-Income Workers. These wage reductions will most seriously affect low-income workers. Most higher-income earners already have health benefits and so will not experience any wage cuts as long as their health insurance meets the new federal requirements.

The employer mandate's burden would primarily fall on lower-income and less-skilled workers who do not currently have health coverage. The House version would force these workers to take the equivalent of an 8 percent pay cut—amounting to $1,600 a year for a full-time worker earning $10 an hour.

Job Losses for Low-Income Workers. On July 24, the federal minimum wage will rise to $7.25 an hour. Employers cannot legally take the full cost of the employer mandate penalty out of the paychecks of anyone earning close to this minimum. Thus, paying $7.25 an hour plus the health care tax will make unskilled workers even more expensive to hire. So, as the CBO points out, their employers will respond by laying them off or hiring fewer of them in the first place:

1. Congressional Budget Office, "Effects of Changes to the Health Insurance System on Labor Markets," July 13, 2009, at *http://cbo.gov/doc.cfm?index=10435* (July 21, 2009).
2. *Ibid*, pp. 2–3.
3. America's Affordable Health Choices Act of 2009, H.R. 3200, 111th Cong., 1st Sess., draft of July 14, 2009, p. 147, lines 14–19.
4. Jonathan Gruber, "The Incidence of Mandated Maternity Benefits," *American Economic Review*, June 1994, Vol. 84, No. 3, pp. 622–641.

> [A] play-or-pay provision would reduce the hiring of low-wage workers, whose wages could not fall by the full cost of health insurance or a substantial play-or-pay fee if they were close to the minimum wage.[5]

Health care reform is supposed to help vulnerable workers. But the House's approach to health care reform will cost many of them their jobs.

Tax Increases on Ordinary Workers. President Obama promised not to raise taxes on workers earning less than $250,000 a year, and supporters of an employer mandate claim that they will not make low- and middle-income workers bear the burden of paying for it. The focus on the surcharge on those earning over a million dollars a year reinforces this impression.

However, low-income workers will bear much of the cost, paying higher taxes indirectly through reduced wages. The House bill imposes what is effectively an 8 percent surtax that applies only to workers who do not already have health insurance, most of whom are already in the lower-income strata and can least afford to pay higher taxes.

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5. CBO, "Effects of Changes to the Health Insurance System on Labor Markets," p. 4.