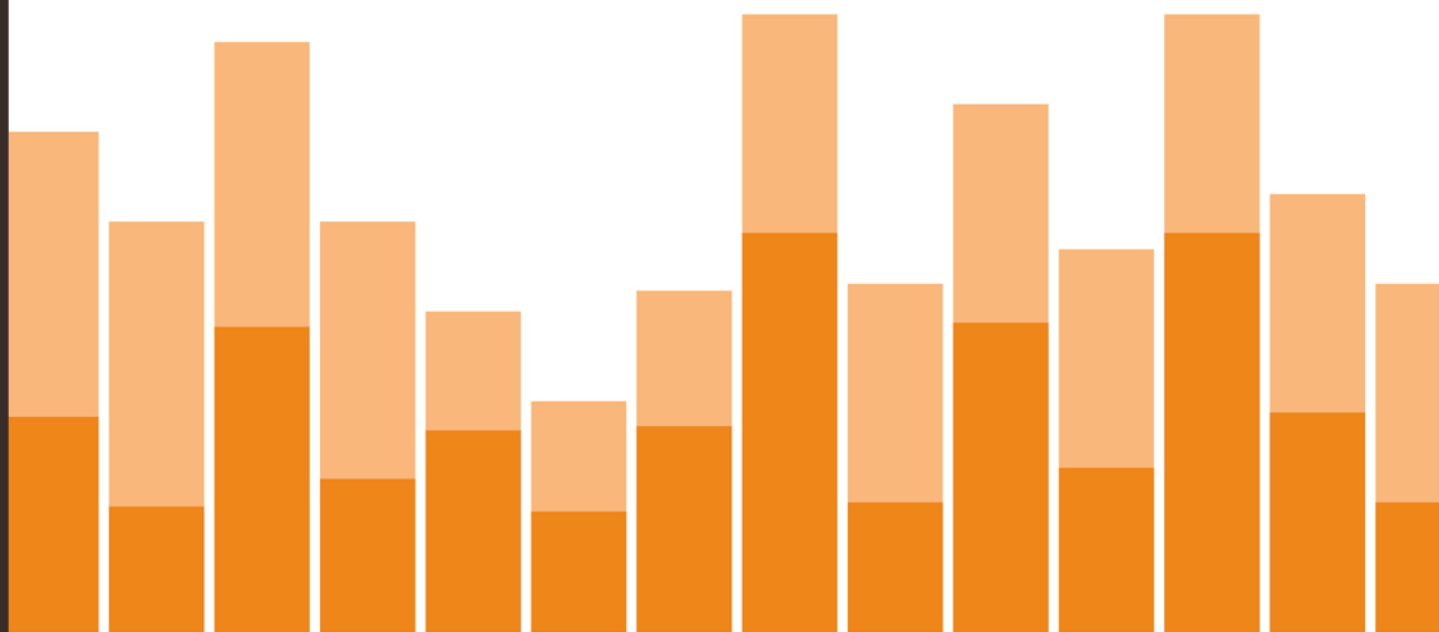


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The Health Care Employment Squeeze: Labor Day 2014

By Tevi D. Troy, Alina Czekai & D. Mark Wilson

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American Health Policy Institute (AHPI) is a non-partisan 501(c)(3) think tank, established to examine the impact of health policy on large employers, and to explore and propose policies that will help bolster the ability of large employers to provide quality, affordable health care to employees and their dependents. The Affordable Care Act has catalyzed a national debate about the future of health care in the United States, and AHPI serves to provide thought leadership grounded in the practical experience of America's largest employers. To learn more, visit americanhealthpolicy.org.

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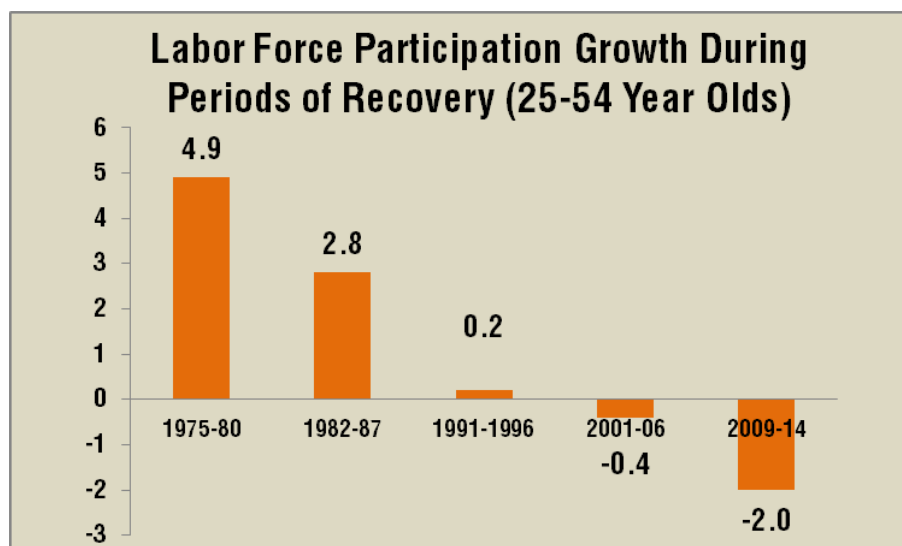
Executive Summary

The labor force participation rate is at an all time low. Even in the recent post-recession period, the labor force participation rate has continued to shrink, and has done so more rapidly than in previous recoveries. Economists and labor market experts have explored a variety of reasons for the lagging state of the labor force participation rate, but one that needs to be considered going forward is the impact of health care on both the supply side and demand side of the U.S. labor market. The combination of both supply side and demand side pressures on the labor force due to health care policies can be characterized as a "Health Care Employment Squeeze." This paper will look at some of the factors contributing to that "squeeze" in order to give policymakers a better sense of how their actions affect labor force participation. Much more research needs to be done to determine the full impact of health policy, and specifically the Affordable Care Act (ACA), on the U.S. labor force. The first step, however, in improving policies is developing an awareness of the problem. This paper is an effort to begin building that awareness.

The Labor Force Participation Rate Challenge

The U.S. unemployment rate has seen significant improvement in recent years, as evidenced by an unemployment rate of 6.2 percent, down from a high of 10.0 percent in October of 2009. The labor force participation rate, however—which is the share of adults either holding a job or looking for one—has continued to fall during the recovery and is at a 36 year low of 62.9 percent. In addition to being at a historically low rate, the growth in labor force participation has also been lagging behind the growth rate in previous recessions (see *Chart 1* below). While the recent recession in the United States was the worst since 1930, the magnitude of the recent recession was not much worse than the double-dip recession of 1980-1982, a period that saw measurable improvement in the overall labor force participation rate despite the adverse business conditions brought on by interest rates exceeding 18 percent.

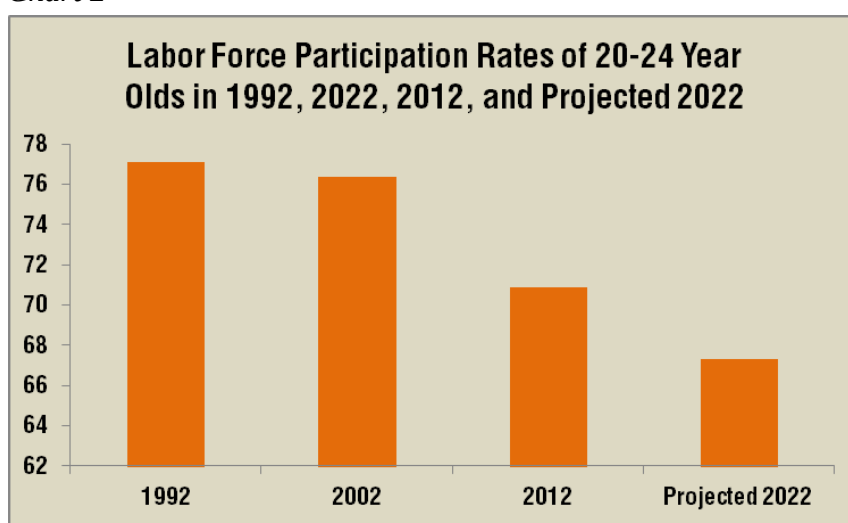
Chart 1



Source: Bureau of Labor Statistics

A number of factors are contributing to today's labor force participation problem. Even before the labor force participation rate was adversely impacted by the 2007-2009 recession, the Bureau of Labor Statistics projected a decline in the rate due to changing demographic factors and an aging population.¹ Furthermore, the youth labor force participation rate has also been dropping, and is projected to continue doing so. Among other factors, the decline in the youth labor force participation could, in part, be attributed to a rise in school enrollment paired with a declining tendency for students to work while they are in school.² According to the Congressional Budget Office (CBO) young adults are also particularly sensitive to cyclical business conditions.³ In 2002, the labor force participation rate among young adults ages 20 to 24 was 76.4 percent.⁴ In 2010, the year of implementation of the Affordable Care Act's (ACA) under 26 health care coverage provision, the labor force participation rate among young adults ages 20 to 24 years old was 73.1 percent. The Bureau of Labor Statistics estimates that by 2022, the labor force participation rate among young adults ages 20 to 24 will fall to 67.3 percent, a projected 3.6 percent decrease since 2012, or a 5.5 percent decrease since 2002.⁵

Chart 2



Source: Bureau of Labor Statistics

Low rates of labor force participation contribute to a number of challenges for policymakers. Fewer people in the labor force means that fewer people are available to pay taxes, or to contribute to long term social safety net programs that rely on contributions of current workers to pay for the costs of future retirees. In addition, individuals out of the labor force are more likely to rely on public benefits themselves, and the maintenance of payments in our system requires a much larger cohort of tax-paying workers than those benefiting from social programs. Furthermore, the longer individuals not in the labor force stay out, the less likely they are to return to the labor force in the future.

The impact of low labor force participation rates is even worse with respect to younger workers. When adults don't work in their younger years, they are less likely to work when they are older and they are less likely to secure well-compensated jobs.⁶ A young adult's first job experience is essential to the development of their job

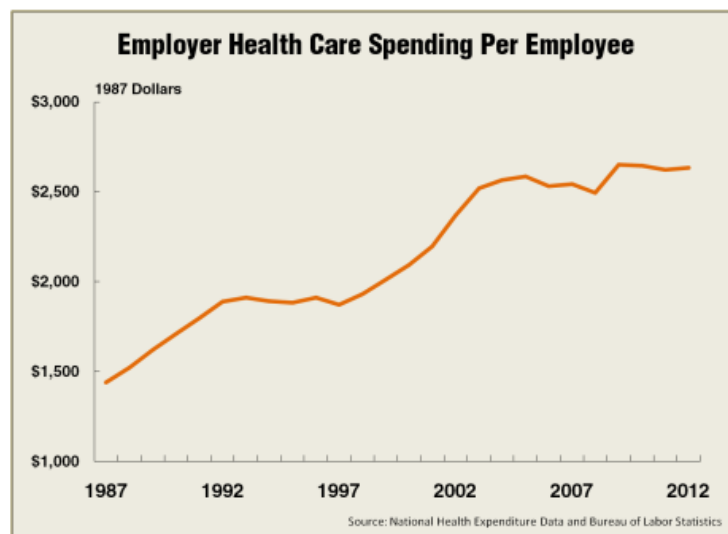
strengths and personal skills, in addition to building connections and constructing a portfolio. Prolonged joblessness, especially in the early stages of an individual's career, not only has negative effects on an individual's self esteem, but also can negatively impact the iterative process.⁷ For all of these reasons, it is important for policymakers to encourage more participation in the labor force, and, in particular, more young adult participation in the labor force.

Our employment based health care system is extremely sensitive to changes in public policies that affect the provision of health care by employers. New pressures and policy changes in this sphere have an impact both on the employers offering jobs and the employees' decision whether to work and which jobs to seek. When viewed together, it is apparent that U.S. health policies may be creating a "Health Care Employment Squeeze," a problematic combination of employers' heightened disincentives to hire and workers' disincentives to work.

Demand Side: Cost of Hiring

Health care spending by employers is on the rise. As the chart below shows, health care spending per employer has grown from about \$1,500 annually to about \$2,600 annually between 1987 and 2012. The rising cost of health care is behind most of this growth. In recent years, however, the Affordable Care Act has added a new component to employer health spending. According to a recent American Health Policy Institute study, the ACA imposes additional costs of \$4,800 to \$5,900 per employee over the course of a decade. Furthermore, employers expect overall ACA-related cost hikes of between \$163 million and \$200 million per employer, or an increase of 4.3 percent in 2016 and 8.4 percent in 2023 over and above what they otherwise would be spending. The total cost of the Affordable Care Act to all large U.S. employers over the next ten years is estimated to be from \$157 billion to \$186 billion.⁸

Chart 3



U.S. employers recognize that they will incur higher costs if they do not make some changes in the ways in which they provide health care to their employees. In fact, the ACA contains a specific provision directly aimed at incentivizing employers to reduce their health care expenditures—the Excise tax which becomes effective in 2018. At the same time, a majority of Chief Human Resource Officers (CHROs) from large companies—63 percent—agreed that the ACA will make it more difficult for their company to control health care costs in the future.⁹ These factors are strong incentives for employers to alter their current behavior. As a result, employers are coping with the high costs of providing health care in a number of ways, including changing their employment practices and work-related financial arrangements.

The ACA's employer mandate, in particular, will likely impact employer behavior. This requirement, which was intended to be implemented in 2014, has now been delayed until 2015. The employer mandate requires that businesses with over 50 full-time equivalent employees provide health insurance to their full-time equivalent employees, or pay per month an "Employer Shared Responsibility Payment" on their federal tax return. Companies with slightly more than 50 workers may respond to the penalties by seeking to hire fewer than 50 workers if their current workforce is below the 50 worker limit. Avoiding the 50 worker threshold will not be an option for large employers, but they may still decrease their workforce so as to lessen the impact of the \$2,000 per worker per year penalty they would face.

Many small employers may consider outsourcing labor or adopting labor-saving technology as well. A recent survey of 691 companies representing single employer plans (including corporations) conducted by the International Foundation of Employee Benefit Plans indicates that nearly one in six employers with 50 or fewer employees has reduced its workforce in response to ACA-related costs. Further, one in ten has reduced hiring in order to stay under the 50-employee ACA threshold for small employers.¹⁰ According to a recent survey by the Federal Reserve Bank of Philadelphia, 18.2 percent of manufacturing employers have reduced both jobs and employees as a result of the ACA, while just 3 percent were hiring more.¹¹

The full effects of these labor demand incentives are yet to be seen. Thus far, the vast majority of large employers have been reluctant to make adjustments to their workforce levels in response to the ACA.¹² According to a survey by the Federal Reserve Bank of Philadelphia, 78.8 percent of businesses had not made hiring changes as a result of the ACA; however, 18.0 percent have increased their shares of part-time workers.¹³ As these figures indicate, businesses are still in the process of deciding how to react to the ACA. Some companies may determine that alterations to their employment level or pay of employees are not worth it and they will choose to absorb, or transfer, the added health care costs through other channels. Still, there is little doubt that employers will take these economic pressures into account when making their staffing and compensation decisions, even if they ultimately decide to absorb some of the higher health care costs.

Supply Side: The Need to Work

According to the Congressional Budget Office (CBO), the ACA contributes to the decision by people not to work. CBO has estimated that, from 2017 to 2024, the ACA will reduce the total number of hours worked by about 1.5 to 2.0 percent.¹⁴ The CBO's rationale for this projection is that individuals will choose to work less given the new benefits they receive through the ACA. The largest declines in labor supply will be among lower-wage workers, those earning income near the federal poverty level, which was \$11,490 for a single person and \$23,550 for a family of four in 2013.¹⁵ Possible ACA-related disincentives to work, as specified by the CBO, may include: exchange subsidies, the expansion of Medicaid, and taxes. The extended health care coverage of child dependents until twenty-six years of age could serve as a disincentive for young adults to work as well.

The ACA established subsidies for lower and middle income Americans that are designed to help them in the purchase of health insurance on the state exchanges. As the subsidy level is dependent on an individual's income level in relation to the Federal Poverty Level (FPL), the ACA subsidies may alter a recipient's incentives to work. For example, some workers could gain eligibility, or become eligible for a higher level of subsidy, by working less.

The impact of subsidies on an individual's incentive to work can be observed in one of two ways: the substitution effect or the income effect. The substitution effect is a possible scenario as the level of subsidies an individual receives may decrease as his or her income rises. A number of social science studies have shown the potential disincentive effects of government benefits, specifically how they can negatively affect the decision whether to work or not.¹⁶ As estimated by Glenn Hubbard, John Cogan, and Daniel Kessler, the size of the subsidy allotted to recipients can decline by as much as 50 cents for each dollar of additional earnings. In order to preserve or gain higher subsidies, work may seem less attractive to some individuals, thus leading them to substitute other activities for work.¹⁷ On the other hand, the income effect could come into play as subsidies increase an individual's overall household income, thus allowing some people to maintain the same standard of living while working less.

Taxes are another factor in individual labor force decisions. For some Americans, the Affordable Care Act will lead to a higher marginal tax rate. According to Casey Mulligan of the University of Chicago, the ACA will increase marginal taxes by an average of five percentage points of employee compensation. Mulligan estimates that the ACA will impose the third largest increase in marginal tax rates in the past 60 years, lowering the return from working by approximately 10 percent.¹⁸ With this estimated increase in marginal tax rate, Harvard's Greg Mankiw suggests there will be a decline in labor supply of about 5 percent in the long-run.¹⁹

In response to the CBO's assessment of the disincentives on both the supply and demand sides of the labor, White House Press Secretary Jay Carney released the following statement:

Over the longer run, CBO finds that because of this law, individuals will be empowered to make choices about their own lives and livelihoods, like retiring on time rather than working into their elderly years or choosing to spend more time with their families. At the beginning of this year, we noted that as part of this new day in health care, Americans would no longer be trapped in a job just to provide coverage for their families, and would have the opportunity to pursue their dreams.²⁰

This statement implicitly acknowledges precisely what the CBO says: some workers will decide to work less as a result of the ACA. This choice may be a good or a bad thing depending on one's perspective, but it seems clear that it will increase downward pressure on the labor force participation rate.

The choice whether to work is becoming even starker for young people. According to the Centers for Medicare and Medicaid Services, young adults represent more than one in five of the uninsured—the highest rate of any age group. Overall, about 30 percent of young adults are uninsured. For this reason, one aspect of the Affordable Care Act that has been particularly popular across the political spectrum is the provision that allows dependents under 26 years old to remain on their parent's health insurance plans. Under this provision, they can take part-time jobs that don't offer health care coverage, decline employer offers coverage if they think their parents' coverage is better, or "free-ride" on their parents plan if they just want higher take-home pay.

In today's job market, younger adults are acquiring stable, well-compensated jobs at a lower rate than in years past and this contributes to the high risk of being uninsured among younger populations.²¹ This was so even before the passage of the ACA. Additionally, many young employees entering the job market for the first time are transitioning into part-time jobs, entry-level jobs, internships, jobs in small businesses or start-up endeavors, or other types of employment that are less likely to offer employer-based insurance. Therefore, the ability to stay on their parents' plan may have the effect of facilitating the growth of part-time work in the economy as they delay their pursuit of longer term jobs with more robust health care benefits.

These pressures take place in the context of a difficult job market for young Americans. Overall, the employment prospects for young adults are poor, as indicated by recent employment rates, labor force utilization, and year-round joblessness. In July 2014, the employment rate of adults age 20 to 24 was 11.3 percent, compared to the 6.6 percent unemployment rate of adults age 25 to 34 years old.²² The many challenges young adults face in acquiring employment may discourage them from engaging in the job search process; the health care employment squeeze appears to be exacerbating this challenge.

Conclusion

One of the most important aspects of a nation's economic vibrancy is its ability to provide jobs for its citizens. A number of factors contribute to a strong employment market, including a growing economy, robust employers, and ready and willing workers. The recent persistent lag in the U.S. labor force participation rate suggests that the U.S. economy must make additional strides in order to create sufficient levels of both supply and demand for labor. Unfortunately, the Health Care Employment Squeeze—the pressures health care imposes on both the supply and the demand for labor – is making it difficult to get the U.S. labor force participation rate back on track and in line with expected patterns of economic recovery.

The labor force participation rate problem has a number of causes. As this paper shows, though, health care policy is a key and often overlooked component of that challenge. Further research is necessary to determine the full extent of the impacts of health policy, and specifically the Affordable Care Act, on employment behavior. As that research develops, decision makers in Washington and around the country need to look at the problem of the Health Care Employment Squeeze, and take both the supply and demand side labor market impacts of health care policy into account in making future determinations about both our health care and our economic systems.

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