THE CADILLAC-TURNED-CHEVY WAGE INCREASE MYTH

The White House, in a post purporting to tell "The Truth on Health Care Reform and Taxes," repeats a claim I've seen just about all defenders of the "They-Call-It-Cadillac-But-It's-Really-A-Chevy Excise tax" make: that the tax will give workers a raise.

> **… for the small sub-set of plans that are affected, the primary impact of this provision will be to increase workers' wages. Getting a pay raise is not what most people would call a tax increase**. Economists agree by taxing the highest cost plans this provision will lead insurance companies to be more efficient and provide quality care to consumers at lower prices (see this endorsement in a letter from a group of prominent economists – including three Nobel laureates and previous members of both Democratic and Republican administrations and this analysis by CBO 2009). Even a report commissioned by the insurance industry's trade association acknowledged that: "[w]e expect employers to respond to the tax by restructuring their benefits to avoid it." [PWC, 2009]. As a result, employers will be in a position to increase workers' take home pay.

I was thrilled to see those three links, because I figured it meant the White House was providing some proof for this claim where I had seen none before.

Here's what those links say.

Economists

The letter "from a group of prominent

economists” says nothing about the excise tax; it only even uses the word “tax” once, and not in the context of funding the health care reform. This is the closest it comes to tying the mode of health care delivery to wages, but this passage says nothing about how you make the health care system more efficient:

> A more efficient health care system would free up resources that could be used to produce other goods and services, and to invest in the future. That would promote economic growth and jobs, along with higher wages and living standards.

So the link to the economists doesn’t even support the Administration’s more general argument for the excise tax, much less its claim that the excise tax will result in higher wages for workers.

CBO

The CBO paper linked to prove this point likewise does not support the point. It does support several related claims, though, that may reveal what the Administration is really thinking about employer-provided care. Here’s what it says in its extended section on employer-based tax.

> Nearly all analysts agree that the current tax treatment of employment-based health insurance—which exempts most payments for such insurance from both income and payroll taxes—dampens incentives for cost control because it is openended. Those incentives could be changed by restructuring the tax exclusion to encourage workers to join health plans with lower premiums; those lower premiums would arise through a combination of higher cost-sharing requirements and tighter management of benefits.
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> CBO’s Budget Options volume discusses a

> number of such changes. One option would replace the current tax exclusion with a refundable but more limited tax credit. Another option would limit the amount of health insurance premiums that could be excluded from income and payroll taxes to specific dollar amounts that represented the 75th percentile of premiums paid by or through employers.17 These approaches would change workers' incentives about how much insurance to purchase and how much care to demand, and they would increase federal revenues by several hundred billion dollars over 10 years.
>
> 17 The dollar amounts in 2010 would be about $17,300 a year for family coverage and about $6,800 a year for individual coverage.

So a CBO report the Administration claims supports their excise tax claims actually argues simply that we need to move away from an employer-based delivery model.

PWC

Finally, the post quotes from a PriceWaterhouseCoopers paper done for AHIP (and widely discredited as industry hack job). The Administration's post doesn't actually claim that this report supports their own claim that the Cadillac tax will raise workers' wages. Rather, it suggests that employers will restructure benefits in response to the tax. Here's the full context for the quote the Administration cites.

> Although we expect employers to respond to the tax by restructuring their benefits to avoid it, we demonstrate the impact assuming it is applied. As the threshold is indexed to CPI-U which has generally been lower than medical trend, it is expected that many plans that currently have premium rates that are

> beneath the threshold will ultimately reach it.

That is, PWC is making the argument that the Cadillac tax will hit tons of plans, not that employers will succeed in avoiding the excise tax. In fact, the report goes further to note that by 2016, even the lowest acceptable plans, Bronze plans, will trigger the tax in metropolitan areas.

> We estimate that in many metropolitan areas, which tend to have higher than average medical costs, the lowest option plan (Bronze Plan) would be considered a "Cadillac plan" as early as 2016. By 2016 at least one of the mandated plans will be considered a "Cadillac plan" and be subject to the 40 percent excise tax in 17 of 50 states.

PWC included that handy map, too, showing how many plans in the Northeast will trigger the tax by 2016 (the darkest red means even plans with a 65% actuarial value will trigger the tax; the report has maps for Florida and California, as well; note, though, I think the Senate has tweaked rates for higher markets since this report, so even assuming the AHIP report is correct, it'll take longer for crappy insurance to be taxed).

In other words, the PWC study shows not what the Administration uses its quote to suggest–that employers will successfully avoid the Cadillac tax–but rather, that even the crappiest allowable plans in more expensive parts of the country will trigger the tax as early as 2016.

Other Sources

The Administration, then, can't muster any support among 3 hand-picked reports for its claim that the Cadillac tax will lead to wage increases. Let's take a look at how others "prove" this claim.

When Nate Silver made the claim today…

> Also, as the CBPP study notes, most of the reduction in premiums that the excise tax would facilitate would be passed back to the workers in the form of higher wages.

He linked to this CBPP study. The CBPP starts its discussion of the great deal this is for workers by committing the same error in citation that the White House piece does.

> Contrary to some reports, the excise tax is unlikely to generate much of an increase in health insurance premiums. Although insurers will try to pass along the cost of the excise tax to consumers by raising the price of health coverage, analysts generally expect that health insurance providers, employers, and consumers will modify their behavior to avoid paying the tax. For example, even the recent, widely criticized report from the consulting firm Pricewaterhouse-Coopers, commissioned by the insurance industry's trade association, admitted, "We expect employers to respond to the tax by restructuring their benefits to avoid it."[10]

Then the report goes on to a Joint Committee on Taxation report.

> Similarly, the JCT writes, "We expect that consumers will seek less costly policies that will reduce their exposure to the excise tax. Cost reductions could be achieved through several strategies, ranging from managed care plans and limited provider networks to more out-of-pocket cost sharing by consumers. When employers offer employees less costly plans, the employees will have less compensation in the form of non-taxable health care benefits and more in

> the form of [taxable] cash compensation.”
>
> JCT projects that only 20 percent of the revenues from the proposal in 2014 will come from the excise tax itself, with the remaining 80 percent coming from additional income and payroll taxes on the increased cash compensation that workers will receive. By 2019, fully 83 percent of the additional revenues will come from taxes on higher wages and salaries, not the excise tax.[11]
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> Based on the JCT figures, the excise tax will reduce spending on employer-sponsored insurance in 2019 by an estimated nearly $74 billion, or about 6 percent — an impressive amount that indicates the measure would be successful in helping to “bend the curve” — and lead to a commensurate increase of nearly $74 billion in wages and other fringe benefits.[12]

Now, I haven’t been able to find the memorandum cited here online. I asked the author of this CBPP report to send it; tomorrow I’m going to try to get it from JCT. But here’s the sum total of what Thomas Barthold, the Chief of Staff, said to Joe Courtney about how this would work:

> As you can see in the table, other than the first year, the percentage owing to excise taxes is declining over the period, as consumers shift away from higher cost health coverage towards increased wage benefits.

Apparently, Barthold believes that consumers—not their bosses—get to choose whether to pay the excise tax or get higher wages. Now, Barthold may have some reason for believing this to be the case, but he appears to not even have considered the possibility that employers will cut health care benefits, but keep wages the same.

Employer Surveys

Which is awfully strange, because a lot of evidence suggests that’s what would happen. A Mercer survey of 465 employer health plan sponsors conducted in November found just 16% would pass on any savings to employees.

> One argument that some have made in favor of the excise tax is that employers cutting benefits would return the savings to employees in the form of higher wages. However, less than a fifth of respondents (16 percent) say they would convert their cost savings into higher pay.

And Towers-Perrin did a survey in September, this of 433 human resource executives, that shows even fewer employers would share savings with employees.

> Although costs are a sensitive business issue today, interestingly, when we asked survey participants how they would respond to various cost scenarios under health care reform, a significant number (ranging from just over a quarter to just over 30%) said they didn’t know what they would do.
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> But among the majority of respondents who did have an expected course of action, the response was very clear. Regardless of the specifics of reform legislation, these employers do not plan to absorb higher health benefit costs and would take a variet of actions to avoid doing so … Nearly all would reduce benefits. Some would cut jobs or salaries. And over a third (38%) would increase prices for customers.
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> Along similar lines, survey respondents who have a clear sense of action in mind (i.e., once again excluding those who

> gave “don’t know” responses) would not shield employees from any cost increases that reform might bring for them …. And if any savings were to result from reform, most employers would retain those savings in the business (Exhibit 12).

So to review:

- 30% in the Towers-Perrin survey said if health reform increases employer costs, they would reduce employment
- 86% in the Towers-Perrin survey said if health reform increases employee costs for health care, they would pass those costs on to employees
- 9% in the Towers-Perrin survey and 16% in the Mercer survey say they would pass on any savings to employees in the form of wage increases

So employers are saying that the fundamental assumption that went into CBO’s and JCT’s calculations on the Cadillac tax are wrong. If the employers are right, it means that employees will get crappier health care–with more out of pocket expenses–but for the most part get no corresponding raise to help pay for those costs. Worse still, this means the revenue calculations will be wrong, because, while the government should be able to tax employers more (if the employers don’t find some other tax loophole), they won’t get any more taxes out of the workers.

Employers Are *Already* Using Health Care Savings to Achieve Profitability

And there's a good reason to believe the employers—and not the government—is right on this count. First, there's anecdotal evidence everywhere. My husband's company, for example, switched from a very good plan to a middling plan (we currently around $9,000 a year in COBRA premiums for the plan) a few years back—precisely the kind of change envisioned under the tax scheme. Not only did he not get a raise in response, but our share of the premiums went up anyway.

And more general reporting shows that, faced with the same challenge the excise tax will present (higher health care costs), employers have already been cutting benefits but using any savings for profits.

> Two-thirds of big companies that cut health-care benefits don't plan to restore them to pre-recession levels, they recently told consulting firm Watson Wyatt. When the firm asked companies that have trimmed retirement benefits when they expect to restore them, fewer than half said they would do so within a year, and 8% said they didn't expect to ever.
>
> Changes like these are reshaping employment in America, injecting uncertainty and delivering the jolting news that pay can go down as well as up. The changes are eroding two pillars of the late-20th-century employment relationship: employer-subsidized retirement benefits and employer-paid health care.
>
> Even as Congress wrestles with how to extend health insurance to more Americans, and considers putting pressure on employers to offer coverage, some companies feel they have no choice but to pull back — dropping health plans or weighing such a move.
>
> [snip]

> The percentage of employers offering health-care benefits is 60% this year, down from 63% in 2008 and 69% in 2000, according to the Kaiser Family Foundation.
>
> In a survey by Hewitt last winter, 19% of large employers said they planned to move away from directly sponsoring health-care benefits over the next five years.
>
> In the meantime, workers' share of health costs is headed up. For next year, 63% of employers that offer health coverage plan to increase employees' share of the expense, according to a survey of 1,500 employers by another consulting firm, Mercer.

So recent years have shown in real world situations that employers faced with rising health care costs will cut benefits and use savings achieved in health care costs to achieve profitability. Employers say that's not going to change with health care reform. Yet, for some reason, the Administration has premised much of its revenue plan for health care reform on just the opposite assumption. I guess if you believe we're going to be in a bubble again by 2013, when the excise goes into effect, then you might be able to argue that a tight labor market will increase the numbers of workers who would get wages–but the WSJ's sources, at least, believe this is a permanent change in the labor market.

The White House claims that if they tax your health care benefits, your wages will go up. But for the overwhelming majority of people, that's simply not true.