

Saving Health Insurance from the Minimum Wage

by John C. Goodman and Richard B. McKenzie

Political support is growing in Congress for another increase in the federal minimum wage. A bill now under consideration would raise the minimum hourly wage from \$5.15 to \$7.25 over the next two years. According to the Economic Policy Institute, an estimated 6.6 million workers currently earn less than \$7.25, and a total of 14.9 million workers would be affected by 2008.¹

What are the likely consequences? Economists have traditionally warned that a higher minimum wage causes more people to be unemployed. [See, for instance, David R. Henderson, "The Negative Effects of the Minimum Wage," NCPA Brief Analysis No. 550.] But a number of studies point to an even more serious consequence: fewer fringe benefits, including health insurance.

An unintended consequence of a minimum wage increase would likely be a rise in the number of Americans without health insurance. Congress can avoid adding to the ranks of the uninsured — in fact, it can make progress toward reducing their number — by giving employers and employees the option of using the amount of the minimum wage increase for health insurance in lieu of wages.

¹Economic Policy Institute, "Minimum Wage Issue Guide: Facts at a Glance," EPI, July 2006.
http://www.epi.org/content.cfm/issueguides_minwage_minwagefacts

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Wages versus Other Benefits. Workers tend to get paid a wage equal to the value of what they produce. So employees who produce \$5.15 worth of goods and services per hour will tend to be paid \$5.15. But what happens if the law makes employment illegal unless the wage is at least \$7.25 per hour? No employer is going to pay \$7.25 for \$5.15 worth of productivity. So employers and employees will seek ways around the law — by reducing nonwage compensation.

In particular, employers may offset the increase in hourly wages by reducing fringe benefits.

- About one in every three employees near the minimum wage has access to such benefits as vacation time, health insurance, holiday pay, employee discounts, uniforms and credit toward college tuition.
- Overall, fringe benefits account for up to 30 percent of total employee compensation.²
- Fringe benefits are not subject to payroll and income taxes; thus, after taxes, \$1 of fringe benefits can equal a \$1.25 or more of wages.

Employers can also reduce labor costs by spending less on working conditions or employee training. Employers may also impose more rigorous work requirements, insisting that employees work faster or work harder.

The net effect of these adjustments is to largely neutralize the cost impact of the minimum wage hike. For example, when the minimum wage increases by \$1, the cost of

² Kosali Ilayperuma Simon and Robert Kaestner, “Do Minimum Wages Affect Non-Wage Job Attributes? Evidence on Fringe Benefits and Working Conditions,” NBER Working Paper, No. 9688, May 2003. <http://www.nber.org/papers/w9688.pdf>

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labor may, on balance, rise by only 5 cents. Workers who retain their jobs are unlikely to be any better off than before. They get more money, but they also get fewer fringes and have to work harder for their pay.

- A 1982 study by Ohio State University labor economist Masanori Hashimoto found that under the 1967 minimum wage hike, employees gained 32 cents per hour in money income but lost 41 cents per hour in on-the-job training, for a net loss of 9 cents per hour in total compensation.
- Economists Linda Leighton and Jacob Mincer concluded in a 1981 study for the American Enterprise Institute that minimum wage increases reduce on-the-job training and, as a result, dampen growth in the real long-run income of covered workers.

Of course, if employers can't reduce fringe benefits (say, because there are none) or are unable to make other adjustments, employees are in danger of losing their jobs.

Wages versus Health Insurance. One of the most important employer benefits that substitutes for money wages is employer-provided health insurance. But health insurance premiums are rising and some employers no longer offer this benefit. Low-wage workers are particularly affected:

- A recent study analyzing the impact of various federal minimum wage increases over a decade found that a 20 percent increase in the minimum wage reduces employer-sponsored health insurance coverage by 4 percent.³

³ Colin Baker, "Minimum Wage Mandates and Employer-Sponsored Health Insurance," Working Paper (Harvard) 2005; found in: Alicia Sasser, "The Potential Economic Impact of Increasing the Minimum Wage in Massachusetts," New England Public Policy Center and Federal Reserve Bank of Boston, 2006. <http://www.bos.frb.org/economic/neppc/researchreports/2006/rr0601.pdf>

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- In most cases the trade-off is dollar for dollar — thus, a \$1 per hour increase in the minimum wage could result in a \$1 per hour decrease in employer-provided health insurance, according to a recent study for the Board of Governors of the Federal Reserve System by economist Louise Sheimer.
- Nationwide, about 26 percent of people below the poverty line lack health insurance, according to the U.S. Census Bureau, and the percentage is much higher in some states.⁴ [See the figure.]

A minimum wage increase will induce even more employers to drop or reduce health insurance benefits, resulting in a further increase in the number of uninsured.

Solution: Creating an Option for Employers. If there is an increase in the minimum wage, employers should be able to count their spending on health insurance for their employees — dollar for dollar — against the minimum wage increase. Specifically, all employers should be allowed to count up to \$2.10 per hour per worker in health benefits toward meeting the minimum wage level. As a result, employers would not have to reduce health insurance benefits to meet the wage mandate.

This option would allow an employer to substitute a nontaxable benefit for taxable wages. For a person working 2,000 hours per year, a \$2.10 increase in nonwage benefits would amount to \$4,200, enough to purchase an individual health insurance policy in most places. A couple, both working at the minimum wage, would have \$8,400, enough to purchase a family policy in most places.

⁴ U.S. Census Bureau, “Health Insurance Coverage: 2004,” U.S. Census Bureau, August 30, 2005.
<http://www.census.gov/hhes/www/hlthins/hlthin04.html>

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Solution: Individually-Owned Insurance. In many states, individual and family insurance is less expensive than group insurance (usually because there are fewer cost-increasing regulations). However, employers currently cannot buy individually-owned insurance for their employees. If they were allowed to, employers could pay some or all of the premiums for insurance employees could take with them as they move from job to job.⁵

Solution: Creating an Option for Employees. Employees should also have the option of applying the minimum wage increase to their own expenses for health insurance. Employers who do not provide health insurance could set up a flexible spending account for employees at minimum cost. Employees could then use (potentially) taxable wage income to purchase nontaxed health insurance instead.

Insuring the Uninsured. Market forces will largely neutralize the impact of a minimum wage increase, and the minimum-wage employee is unlikely to be much better off than before the increase. However, if the health insurance option is part of the legislation, it offers an opportunity to reduce rather than increase the number of Americans without health insurance.

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⁵ John C. Goodman, "Ten Easy Health Reforms," National Center for Policy Analysis, Brief Analysis No. 497, January 14, 2005. <http://www.ncpa.org/pub/ba/ba497/>