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Do more health insurance options lead to higher wages? Evidence from states extending dependent coverage☆

Marcus Dillender*

W.E. Upjohn Institute for Employment Research, 300 South Westnedge Avenue, Kalamazoo, MI 49007-4686, United States

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ABSTRACT

Little is known about how health insurance affects labor market decisions for young adults. This is despite the fact that expanding coverage for people in their early 20s is an important component of the Affordable Care Act. This paper studies how having an outside source of health insurance affects wages by using variation in health insurance access that comes from states extending dependent coverage to young adults. Using American Community Survey and Census data, I find evidence that extending health insurance to young adults raises their wages. The increases in wages can be explained by increases in human capital and the increased flexibility in the labor market that comes from people no longer having to rely on their own employers for health insurance. The estimates from this paper suggest the Affordable Care Act will lead to wage increases for young adults.

1. Introduction

Labor market and human capital decisions made by young adults can have lasting impacts on their careers. Despite this, little is currently known about how the need for health insurance coverage affects young adults' labor market decisions. Understanding this is particularly important in light of the fact that extending dependent coverage to young adults is a major component of the Affordable Care Act. Economic theory suggests that having access to employer-sponsored health insurance through a source other than one's own employer could lead to wage increases by reducing job-lock, by allowing people to sort into higher paying jobs that do not offer health insurance, and, as this paper finds, by increasing education. Testing this empirically is difficult, however, because having an alternate source of health insurance, whether it is through a spouse or a parent, is often the outcome of a joint decision. This paper avoids this endogeneity issue by using plausibly exogenous variation in access to a parent's employer-sponsored health insurance plan that is induced by states implementing a minimum age until which employers must provide health insurance to employees' children.

Before the Affordable Care Act required all employers to provide health insurance to employees' children until the age of 26, many states passed reforms that extended dependent coverage to young adults. These reforms gave young adults access to another source of health insurance apart from school or employment and at a price drastically lower than the private market. Although these reforms increased access to employer-sponsored health insurance for young adults, research on the reforms suggests they did not have a dramatic effect on overall health insurance coverage levels. Both Levine et al. (2011) and Monheit et al. (2011) use health insurance data from the Current Population Survey to study how these reforms affected health insurance levels. Levine et al. find that overall health insurance rises by about 3 percentage points for young adults, while Monheit et al. find that the main effect of these reforms was to allow young adults to switch from insurance through their own employers to insurance through their parents' employers.

Increased flexibility in the labor market and being able to gain employer-sponsored health insurance through a source other than one's own employer could lead to changes in labor market decisions in a number of ways. First, it could affect education decisions.

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* Tel.: +1 269 385 0435.
E-mail address: dillender@upjohn.org

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Attending college at later ages often means people cannot have employer-sponsored health insurance since employers generally allow employees' children to stay on their insurance until the age of 22 at the latest in the absence of the reforms. This makes the opportunity cost of attending college after the age of 22 even higher than the forgone wages since employer-sponsored health insurance is typically cheaper and provides more coverage than individual insurance. Additionally, many colleges require students to have health insurance, which essentially raises the price of college for people without easy access to health insurance. Thus, allowing young adults to stay on their parents' health insurance until later ages could lower both the real and opportunity cost of attending college, which could induce marginal people to attend college and then earn higher wages due to their higher human capital.

Second, having a source of health insurance other than through one's own employer could reduce job-lock, which is the loss of job mobility that arises from the non-portability of employer-sponsored health insurance. As Madrian (1994) argues, with job-lock lessened, people are free to leave their current jobs to find better matches and potentially higher wages. This would be particularly important early in people's careers before people gain experience in careers that are not their best matches.

Finally, compensating differential theory suggests that receiving health insurance through a job should lower wages. This suggests that extending dependent coverage to young adults would allow them to earn higher wages by sorting into jobs that do not offer health insurance.

This study contributes to the literature along a number of dimensions. First, the results of this paper help us understand what extending health insurance to young adults does and suggest the Affordable Care Act could increase education and wages for young adults. Second, knowing what extending dependent coverage does to education levels helps us understand people's education decisions. Increased college attendance at older ages would suggest the U.S. reliance on employer-sponsored health insurance may prevent people from investing in their human capital.

To determine how this new avenue for obtaining health insurance affects young adults' education and wages, I use data from the Census and the American Community Survey. The estimation strategy compares how education and wages change for eligible young adults after the reforms while accounting for state and national trends. The paper primarily focuses on people older than 22, as younger individuals could generally access parental insurance prior to the change in legislation if they were enrolled in college. I begin by estimating a time-flexible specification that allows the effects of the reforms to vary by an individual's age at the time of the reform. Doing this shows that the reforms begin to affect people 18 or younger at the time of passage, likely because people 18 and younger have not yet made their higher education and labor force decisions and have not left their parents' health insurance.

I find that wages increase after the age of 22 for those who were 18 or younger when dependent coverage was extended. Women experience wage increases of about 3.1 percent while they have access to insurance through their parents' employers. These wage increases largely persist even after young women no longer have access to insurance through their parents' employers. Young men experience wage increases of about 1.6 percent after they can no longer remain on their parents' health insurance. For men, this persistent change can be attributed almost entirely to changes in education, which increases by about 0.17 years on average. The education gains for women, which are only about 0.07 years and are statistically insignificant, do not seem to explain much of the wage increase. Labor force participation falls slightly for people in their early twenties as men enroll in college and women take more time before entering the labor force. Once young adults are no longer eligible for insurance through their parents' employers, labor force participation returns to the pre-reform levels. Scaling the wage estimates to account for the fact that more employers will have to provide coverage under the Affordable Care Act suggests that the Affordable Care Act will increase wages by an average of 3.5 and 4.6 percent for people who were 18 or younger when the act was passed.

The paper unfolds as follows. The next section discusses previous work on health insurance and the labor market. Section 3 discusses the extensions in dependent coverage. Section 4 outlines a conceptual framework for how extending dependent coverage could affect labor market outcomes. Section 5 describes the data. Section 6 discusses the empirical strategy and presents the estimates of the effect of defining dependency status on education levels, education timing, and wages. Section 7 provides a discussion of the results, presents estimates of the effects of extended dependent coverage on health insurance, and summarizes the results of a series of placebo regressions. Section 8 concludes.

2. Previous literature on health insurance and the labor market

Employer-sponsored health insurance is cheaper and provides more coverage than individual insurance because of a tax structure that favors employers providing insurance and because risk-pooling is typically easier for employers than for individuals. Furthermore, concerns over adverse selection are a major driving force in the supply-side of the individual market. These factors contribute to the attractiveness of employer-sponsored health insurance relative to alternative sources of health insurance.[1]

Early work identified the effects of an outside source of coverage by treating husbands' health insurance as exogenous in women's labor market decisions.[2] There are two issues with this approach. The first is that the benefits packages of husbands are likely correlated with their unobservable ability and, because of assortative mating, with the unobservable ability of wives. Thus, having an outside option in this case is correlated with an individual's unobserved ability. The second issue, as Currie and Madrian (1999) point out, is that labor force decisions for married men and women may be the outcome of a joint decision, meaning treating one person's health insurance as exogenous may yield inconsistent estimates.

Olson (2002) and Kapinos (2009) deal with assortative mating by instrumenting for a husband's insurance coverage using various characteristics of the husband's job. They find an outside source of insurance coverage raises wages and lowers labor force participation. Although both Olson and Kapinos carefully consider assortative mating, they still make the problematic assumption that couples do not make joint decisions.

This study addresses two key limitations with this literature. The first is one of internal validity in that this paper focuses on an environment in which people making joint decisions is less of a concern since children cannot supply their parents with health insurance. This paper also uses plausibly exogenous variation in the ability to access the outside coverage, meaning the results hold even though parents and children have correlated unobservable traits.

The main contribution of this paper is that it focuses specifically on young adults, whom we know very little about. Since

[1] See Currie and Madrian (1999) and Buntin et al. (2004) for discussions of the advantages that employers have in providing health insurance.

[2] See Buchmueller and Valletta (1999), Holtz-Eakin et al. (1996), and Lombard (2001) for examples.