



# How does retiree health insurance influence public sector employee saving?<sup>☆</sup>



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## ABSTRACT

Economic theory predicts that employer-provided retiree health insurance (RHI) benefits have a crowd-out effect on household wealth accumulation, not dissimilar to the effects reported elsewhere for employer pensions, Social Security, and Medicare. Nevertheless, we are unaware of any similar research on the impacts of retiree health insurance per se. Accordingly, the present paper utilizes a unique data file on respondents to the Health and Retirement Study, to explore how employer-provided retiree health insurance may influence net household wealth among public sector employees, where retiree healthcare benefits are still quite prevalent. Key findings include the following:

- Most full-time public sector employees anticipate having employer-provided health insurance coverage in retirement, unlike most private sector workers.
- Public sector employees covered by RHI had substantially less wealth than similar private sector employees without RHI. In our data, Federal workers had about \$82,000 (18%) less net wealth than private sector employees lacking RHI; state/local workers with RHI accumulated about \$69,000 (or 15%) less net wealth than their uninsured private sector counterparts.
- After controlling on socioeconomic status and differences in pension coverage, net household wealth for Federal employees was \$116,000 less than workers without RHI and the result is statistically significant; the state/local difference was not.

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In the United States, the cost of retiree health care insurance can be very steep indeed. For retirees too young for Medicare, estimated annual health insurance premiums easily amount to \$14,000

per year for a couple.<sup>2</sup> Even for those age 65 and older covered by Medicare, out-of-pocket costs for a median couple can be \$5300 per year (Hoffman and Jackson, 2012). Accordingly, as workers plan for and look ahead to retirement, they must increasingly recognize that health insurance costs may profoundly affect both their health and their ability to consume other goods and services during their golden years.

Employees who anticipate that they will be included in employer-provided group health insurance plans post-retirement will most likely need to save less during their working careers due to the generosity of this benefit. For this reason, economic

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<sup>2</sup> See McArdle et al. (2012). We also generated similar estimates using online calculators for a hypothetical couple both age 60 for PPO coverage with no deductible and \$20/\$30 co-payments in the State of Pennsylvania; cf. <http://www.ehealthinsurance.com/ehi/ifp/compare-plans?noSelectedPlan=true>.

theory predicts that employer-provided retiree health insurance (RHI) benefits would be hypothesized to have a crowd-out effect on private household wealth accumulation, not dissimilar to that reported elsewhere for employer pensions, Social Security, and Medicare.<sup>3</sup> An interesting theoretical question is whether this crowd-out should be dollar for dollar, or somewhat less. The magnitude of any reductions in retirement saving would be influenced by the extent of the employer subsidy (the proportion of the premium paid by the employer), the expected value of the promised health insurance, whether individuals expect to achieve the required years of service to qualify for the benefit, whether employees expect that the employer will honor the promise to provide the insurance, and whether spouses/partners and dependents can be included in the plan.

While numerous studies have previously estimated the impacts of pension and Social Security benefits on household retirement asset accumulation,<sup>4</sup> we are unaware of any similar research on the impacts of retiree health insurance per se. Accordingly, the present paper explores how employer-provided retiree health insurance may influence net household wealth among public sector employees, where RHI benefits are still quite prevalent.

In the U.S., most private sector U.S. firms no longer offer post-retirement healthcare benefits (Fronstin, 2010). By contrast, most public sector employers do continue to offer job-based health insurance to retired employees (Clark and Morrill, 2010). Still, the rising cost of RHI is beginning to challenge state and local governments' ability to continue providing this benefit over time (GAO, 2007; Moran, 2010). In fact, of late, some public employers have begun to implement RHI plan constraints by, for instance, limiting coverage to workers with long tenure and shifting an increasing share of the plan premiums to retirees. Some public employers have also imposed cost-shifting on active and retired workers (Coggburn, 2010). These changes are all taking place against the backdrop of national changes in the healthcare environment, particularly with the 2010 passage of the Affordable Care Act (ACA). The law's impacts, as we argue below, will be felt by public sector employers who offer health plans for active as well as retired employees.<sup>5</sup>

Economists and policy analysts have devoted considerable attention to examining the impact of pension plans on individual saving and retirement decisions. Nevertheless, only a handful of studies ask how RHI shapes key lifetime choices influencing retiree wellbeing, to date. The present paper offers the first comprehensive empirical analysis of the impact of retiree health plans of wealth accumulation of public employees. In what follows, we begin with a review of retiree health plans in the public sector. Next, we evaluate how the promise of subsidized retiree health insurance affects the need to save for retirement. As noted, theory suggests that workers covered by retiree health insurance would be likely to *save less* and

*retire earlier* than comparable workers not covered by this type of retirement plan. Here, we focus on the first hypothesis; Shoven and Slavov (2013) have a recent paper addressing the second.

To conduct the empirical analysis, we utilize a unique data file on three baseline cohorts surveyed in the Health and Retirement Study (HRS). Our general strategy is to first generate household wealth values using the HRS, and then we compare these wealth values across workers covered by retiree health insurance plans versus those of their non-insured counterparts. We control for whether the workers held jobs with Federal, state or local government employers, or whether they worked for the private sector. A variety of controls is also taken into account as will be detailed below, to make employee attributes as similar as possible. Our key findings may be summarized as follows:

- Most full-time public employees anticipate having health plan retiree coverage, unlike many private sector workers.
- Public sector employees covered by retiree health plans had substantially less wealth than similar private sector employees without retiree health insurance. In our data, Federal workers had about \$82,000 (18%) less net than private sector employees lacking RHI; state/local workers with RHI accumulated about \$69,000 (or 15%) less net wealth than their uninsured private sector counterparts.
- After controlling on socioeconomic status and differences in pension coverage, net household wealth for Federal employees was \$116,000 less than workers without RHI and the result is statistically significant. The state/local difference was not significant, nor was that of private sector employees who report RHI coverage.

In a final section, we consider how state and local government RHI benefits might respond to the implementation of the Affordable Care Act taking effect January of 2014. We suggest that the introduction of state insurance exchanges and Federal subsidies for low-income retirees may alter the labor market for public sector employees in important ways.

## 1. Retiree health plans in the public sector

To clarify the role of retiree health insurance in retirement planning, we begin by examining how these plans vary across state, local, and Federal government employers, and over time. Specific plan impacts are anticipated to depend on plan generosity and the extent of the RHI subsidy provided by the employer.

Most full-time U.S. public sector employees today are covered by health plans that extend benefits to retirees, yet these plans differ in their generosity and eligibility requirements across governmental units (Clark and Morrill, 2010). Also, in the public sector, the nature of the benefit and its cost may depend on individual worker characteristics. For instance, state or local governments often pay a higher percentage of the RHI premium for longer-tenured workers. In what follows, we briefly review key provisions of retiree health insurance plans for each of the main groups of public sector workers: state employees and teachers, local government workers, and Federal employees.<sup>6</sup>

### 1.1. Retiree health plans for state employees and teachers

All states provide health insurance for their full-time active employees, and they also usually offer retired employees the

<sup>3</sup> For instance, Gruber and Yelowitz (1999) find a strong negative effect of Medicaid eligibility on wealth. Focusing on elderly households, Levin (1995) reported some evidence for precautionary saving by those having little health insurance, while Starr-McCluer (1996) found only mixed evidence that U.S. households facing greater health risks accumulated more wealth (the latter study did not differentiate active worker coverage from prospective retiree health insurance, however). Guariglia and Rossi (2004) use UK data and discern some crowding-out of private saving when publicly provided health coverage is of poor quality. Yet none of these studies explicitly focuses on retiree health insurance among public versus private sector employees, as we do here.

<sup>4</sup> For instance Hurd et al. (2012:107) use cross-national micro datasets to conclude that "extra dollar of pension wealth depresses accumulated financial assets around the time of retirement by 22 cents."

<sup>5</sup> For instance Segal (2013:7) states that "[s]ponsors of state employee plans will be able to compare the cost and value of those plan offerings to what the public Exchanges are offering."

<sup>6</sup> For an examination of military benefits, see <http://www.tricare.mil/>. We do not cover these in detail here due to an extremely small number of respondents employed by the U.S. armed forces in the HRS data.

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