



T-66

U.S. House of Representatives
Committee on Ways and Means
Subcommittee on Oversight

Hearing on

Employer-Sponsored Retiree Health Insurance
September 15, 1988

Statement of

Deborah J. Chollet, Ph.D.
Senior Research Associate

The views expressed in this statement are solely those of the author. They should not be attributed to the officers, trustees, members, associates, contributors or subscribers of the Employee Benefit Research Institute, its staff, or its Education and Research Fund.

EMPLOYEE BENEFIT RESEARCH INSTITUTE

2121 K Street, NW / Suite 600 / Washington, DC 20037-2121
Telephone 202-659-0670 FAX 202-775-6312

Retiree health insurance--its cost, funding and future--has become the basis of major concern and controversy among employers and public policy makers. Data on the prevalence or distribution of these benefits have been scarce. Nevertheless, employers with retiree health plans have claimed that funding these benefits during active workers' careers (similar to the way that pensions are funded under current law) would represent an enormous current expense. While the Congress has been concerned that retirees who expect these benefits may have no real claim to benefits in the event a plan termination or sponsor bankruptcy, the prospect of tax revenue losses may impede legislation allowing tax preferences to encourage employer funding.

This testimony examines the prevalence of retiree health insurance as an employee benefit, and the prevalence and distribution of retiree health insurance benefits among both early retirees (age 55 to 64) and retirees age 65 or older. The data presented include (and distinguish between) retirees who receive private-plan benefits and those who receive benefits from a public employer plan--federal, state or local governments. Revised estimates of the present value of employer liability are presented, differentiating between the liability of private and public employers and between liability for benefits being provided for current retirees versus future benefits for workers not yet retired. Finally, estimates of the annual cost to employers of amortizing unfunded liability for current retirees and workers are presented.

Retiree Health Insurance as an Employee Benefit

Continuation of health insurance benefits after retirement is a common feature of both private and public employer plans. In 1986, three-quarters (75.2 percent) of full-time workers in medium or large private-sector establishments participated in health insurance plans that continued coverage after early retirement (before age 65); more than two-thirds (68.4 percent) participated in plans that continued coverage after retirement at age 65 (U.S. Department of Labor, 1987).

Most plans that continue coverage after retirement also provide for an employer (or sponsor) contribution to the cost of coverage (see Table 1). In 1986, 64 percent of full-time workers in medium or large private-sector establishments had plans that continued coverage after early retirement with the plan sponsor paying all or part of the plan cost; 58 percent had plans with fully or partly sponsor-financed coverage after retirement at age 65. Approximately 39 percent of workers in larger private-sector establishments had health insurance plans for which the plan sponsor paid the full cost of coverage after either early or normal retirement.

Fully or partly sponsor-paid retiree coverage is less common among public-sector workers (state and local government employees) than among private-sector workers in larger establishments. In 1987, nearly half (47 percent) of full-time state or local government workers with employer-based health insurance had plans that would continue with a sponsor contribution after early retirement; 44 percent had coverage that would continue with a sponsor contribution after retirement at age 65. About one-half of state and

Table 1
 Percent of Private- and Public-Employer Health Insurance
 Plan Participants with an Employer Contribution to Coverage
 After Retirement, by Selected Benefit Provisions
 and Age of Retiree, 1986-1987

Benefit Provision	Medium-Size and Large Private Employer Plans ^a		State and Local Public Plans ^b	
	Retirees Under 65	Retirees 65 or Older	Retirees Under 65	Retirees 65 or Older
With retiree coverage	64%	58%	47%	44%
Effect of retirement on benefit level:				
No change	50	46	45	41
Reduced coverage	12	10	3	3
Increased coverage	1	1	c	c
Retiree share of cost:				
Partial cost	19	14	24	23
No cost	33	34	24	24
No retiree coverage	22	29	48	52
Provision not determinable	2	2	2	2
Retiree policy not established	1	1	d	d
Other ^e	1	1	d	d

Source: Estimated from: U.S. Department of Labor, Bureau of Labor Statistics, Employee Benefits in Medium and Large Firms, 1986, Bulletin 2281 (Washington, D.C.: U.S. Government Printing Office, June 1987), Tables 29 and 30; and U.S. Department of Labor, Bureau of Labor Statistics, Employee Benefits in State and Local Governments, 1987, Bulletin 2309 (Washington, D.C.: U.S. Government Printing Office, May 1988), Tables 48 and 49.

Note: Data reflect benefits provided to full-time permanent employees. Detail may not add to totals because of rounding or because the specific provision was indeterminable.

^aData are for 1986, and exclude 11 percent of participants in plans which continue access to coverage after retirement other than that required by federal law (COBRA), but to which the employer does not contribute. Estimates assume that specific benefit provisions are proportionately distributed among plans to which the employer does contribute.

^bData are for 1987. Data on the number of participants with retiree plans to which the employer does not contribute are unavailable.

^cLess than 0.05 percent.

^dNo plan participants in this category.

^eIncludes employees who participate only in the employer's dental insurance plan and for whom health insurance coverage and provisions are unknown.

local employees that participate in plans where the employer contributes have the full cost of coverage after retirement paid by the plan sponsor.

Employer plans that continue coverage typically continue benefits at the same level as that provided to workers before retirement; that is, the scope of services covered and retirees' cost-sharing under the plan are maintained at preretirement levels. However, presumably all plans integrate Medicare coverage into plan benefits. That is, Medicare is "first-payor" for services covered by both Medicare and the retiree plan.¹ Because Medicare integration substantially reduces plan costs, it has probably encouraged the growth of health insurance as a retiree benefit.

Since 1981 (the first year for which data are available), the number of workers with health insurance plans that continue coverage after retirement has grown substantially. Between 1981 and 1985, the number of private-sector workers with plans that provide benefits after early retirement grew by more than 14 percent (see Table 2); the number of private-sector workers with plans that continue coverage after age 65 grew 18 percent. The most rapid growth of retiree benefits occurred among workers in manufacturing establishments and workers in very large establishments (establishments with 2500 workers or more). The number of workers in medium-size and large manufacturing establishments with plans that continue benefits after retirement at age 65 grew nearly 20 percent between 1981 and 1985. The number of workers in very large establishments with this benefit grew 50 percent.

¹Alternative methods of Medicare integration are described in: D.J. Chollet and R.B. Friedland, 1987.

Table 2
 Number and Percent of Workers in Employer-Sponsored Health Insurance Plans
 with an Employer Contribution to Coverage After Early or Normal Retirement:
 Medium-Size and Large Private Establishments
 by Establishment Size and Industry Group, 1981-1985

Establishment size/ Industry group	1981		1985		Percent Increase in Work- ers with provision, 1981-85
	Number (in millions)	Percent	Number (in millions)	Percent	
<u>Early retirement^a</u>					
All participants with an employer contribution to retiree coverage	11.2	61.1%	12.8	63.9%	14.3%
Establishment size:					
100 - 249	0.8	39.3	1.1	46.2	37.5
250 - 499	1.6	45.7	1.6	40.6	b
500 - 999	2.4	61.3	2.2	63.4	-8.3
1,000 - 2,499	2.4	64.8	2.8	72.5	16.7
2,500+	3.5	73.2	5.0	80.7	42.9
Industry group:					
Manufacturing	6.3	59.7	7.3	64.4	15.9
Nonmanufacturing	4.8	63.2	5.4	63.3	12.5
<u>Retirement at age 65^c</u>					
All participants with an employer contribution to retiree coverage	10.0	55.0	11.8	58.9	18.0
Establishment size:					
100 - 249	0.8	39.3	1.0	42.6	12.5
250 - 499	1.3	37.1	1.5	36.4	15.4
500 - 999	2.2	55.5	1.9	54.2	-13.6
1,000 - 2,499	2.2	58.7	2.6	67.3	18.2
2,500+	3.2	67.9	4.8	76.8	50.0
Industry group:					
Manufacturing	5.6	52.4	6.7	59.1	19.6
Nonmanufacturing	4.5	58.6	5.0	58.6	11.1

Source: Michael A. Morrissey and Gail A. Jensen, "Employer-Sponsored Post-Retirement Health Benefits: The State of Knowledge and Some Unresolved Issues," University of Alabama at Birmingham, working paper (September 1988); and Gail A. Jensen, unpublished tabulations of the U.S. Department of Labor Employee Benefit Survey, 1981 and 1985.

Note: Detail may not add to totals because of rounding.

^aData include workers with coverage that continues at least until age 65; workers with some other limited period of continuation are not included.

^bNo measurable change.

^cData include only workers with coverage that continues indefinitely; workers with a limited period of continuation are not included.

Retirees with employer-sponsored coverage

Employer-sponsored plans are an important source of health insurance among retirees. In 1984 (the most recent year for which data are available), at least 11.3 million retirees age 55 or older had health insurance from an employer-sponsored plan (see Table 3). Of these, 7.6 million were age 65 or older. Among all elderly in 1984, at least 29 percent reported having health insurance coverage from a past employer.

The evolution of retiree coverage as a feature of employer health plans is reflected in higher rates of retiree coverage among recent retirees. In 1984, nearly one-third of the elderly age 65-69 (33 percent) reported health insurance coverage from a past employer, compared to just over one-quarter (26 percent) of elderly age 75 or older.

Employer-sponsored retiree health insurance plans represent a substantial share of the elderly's Medigap insurance (see Table 4). Among all people age 65 or older with private insurance to supplement Medicare (62 percent of the elderly in 1984), about one-half--47 percent--had all or part of that coverage provided by an employer-sponsored retiree health insurance plan. Including employer coverage presumed to be received as a current worker benefit, but possibly received as a retiree, nearly 60 percent of the elderly with private coverage to supplement Medicare derived all or part of that coverage from an employer plan.

Most retirees who report health insurance from a past employer live in low- and middle-income families. Consequently, health insurance benefits

Table 3
 Number and Percent of People Age 55 or Older
 with Retiree Health Insurance by Age, 1984

Retiree age	Number ^a (in millions)	Percent within age group	Percent of all people with retiree health insurance
Total	11.3	23.6	100.0
Age 55-59	1.2	10.2	10.2
Age 60-64	2.6	24.4	23.1
Age 65-69	2.9	32.9	25.2
Age 70-74	2.1	30.0	18.8
Age 75+	2.6	26.3	22.6
Summary:			
Under age 65	3.8	17.1	33.4
Age 65 or older	7.6	29.6	66.6

Source: Preliminary EBRI tabulations of the Survey of Income and Program Participation, matched Waves 2 through 5 (U.S. Department of Commerce, Bureau of the Census).

Note: Data omit individuals living in households that were not interviewed at any time during the calendar year. Items may not add to totals because of rounding.

^aIncludes primary-insured retirees and people with dependents' coverage.

Table 4
 Percent of People Age 65 or Older with Health Insurance
 from Selected Sources, by Age, 1984

Source of coverage	Total, Age 65+	Age 65-69	Age 70-74	Age 75+
Active worker coverage from a current employer	8.5%	16.4%	7.2%	2.5%
Direct ^b	5.6	10.4	5.1	a
Dependent's coverage ^c	2.9	6.0	2.1	a
Retiree coverage from a past employer	29.6	32.9	30.0	26.3
Direct ^b	23.7	24.7	23.6	22.9
Dependent's coverage ^c	5.9	8.2	6.4	3.4
Other private insurance	54.8	48.6	58.2	57.9
No private insurance	38.1	31.7	36.3	45.1

Source: Preliminary EBRI tabulations of the Survey of Income and Program Participation, matched Waves 2 through 5 (U.S. Department of Commerce, Bureau of the Census).

Note: Data omit individuals living in households that were not interviewed at any time during the calendar year. Items may not add to totals because of rounding.

^a Statistically insignificant.

^b Includes people with survivors' coverage and those who report both direct and dependent's coverage of the same type.

^c Excludes people with both direct and dependent's coverage of the same type.

represent an important real income supplement for most of the retirees that have them. In 1984, more than one-half of the elderly with retiree health insurance (56 percent) had family income of less than \$20,000; 79 percent had family income of less than \$30,000 (see Table 5). Retirees under age 65 with health insurance from a past employer report slightly higher, but generally comparable levels of family income. In 1984, 47 percent of early retirees with employer-sponsored health insurance reported family income of less than \$20,000; 76 percent reported family income of less than \$30,000.

Available data do directly not indicate whether the health insurance benefits that retirees are now receiving are sponsored by a private or public employer. Nevertheless, most retirees' health plan sponsors can be inferred from available data about their pension plan sponsors. From those data, we estimate that at least half of all retirees with health insurance from a past employer receive coverage from a private employer plan; that is, the retiree also receives income from a private pension plan (see Table 6). While 20 percent of retirees with health insurance from a past employer report no current pension income, most of these individuals probably receive their health insurance benefits also from a private plan sponsor. At least 30 percent of retirees now receiving health insurance from a past employer have coverage as a retiree from public employment--federal, state or local government.

Evidence that private employer plans have been providing retiree benefits with increasing frequency, and that retiree coverage as a public plan benefit matured relatively early, is again apparent in the relatively high rate of

Table 5
Number and Distribution of People with Retiree Health Insurance,
by Family Income and Age, 1984

Family Income	<u>Recipients Under Age 65</u>		<u>Recipients Age 65 or Older</u>	
	Total ^a (in millions)	Cumulative percent of beneficiaries	Total (in millions)	Cumulative percent of beneficiaries
less than \$10,000	0.5	11.7	1.2	14.8
\$10,000 - \$14,999	0.7	29.2	1.5	35.2
\$15,000 - \$19,999	0.7	46.7	1.6	55.8
\$20,000 - 24,999	0.4	63.8	1.2	70.2
\$25,000 - \$29,999	0.5	76.2	0.7	79.4
\$30,0000 - \$39,999	0.5	88.3	0.8	89.7
\$40,000 or more	0.5	100.0	0.8	100.0

Source: Preliminary EBRI tabulations of the Survey of Income and Program Participation, matched Waves 2 through 5 (U.S. Department of Commerce, Bureau of the Census).

Note: Data omit individuals living in households that were not interviewed at any time during the calendar year. Items may not add to totals because of rounding.

^aIncludes only retirees ages 55-64.

Table 6
 Number and Percent of People Age 55 or Older
 with Retiree Health Insurance by Type of Pension Plan Sponsor^a
 and Recipient Age, 1984

Recipient Age	Total with retiree health coverage (in millions)	Percent with pension income			Percent with no pension income
		Total ^b	Private pension	Public pension ^c	
Total	11.3	79.8%	50.2%	29.7%	20.2%
Age 55-59	1.2	78.7	44.7	34.1	21.3
Age 60-64	2.6	82.3	54.5	27.8	17.7
Age 65-69	2.9	82.1	54.0	28.1	17.9
Age 70-74	2.1	79.2	49.6	29.6	20.8
Age 75+	2.6	75.8	44.4	31.4	24.2
Summary:					
Age 55-64	3.8	81.2	51.4	29.7	18.8
Age 65+	7.6	79.1	49.5	29.6	20.9

Source: Preliminary EBRI tabulations of the Survey of Income and Program Participation, matched Waves 2 through 5 (U.S. Department of Commerce, Bureau of the Census).

Note: Data omit individuals living in households that were not interviewed at any time during the calendar year. Items may not add to totals because of rounding.

^aFor people with only dependent's coverage from a spouse's plan, the spouse's pension plan sponsor is reported.

^bAlso includes military pensions and other pensions from unspecified sources.

^cFederal, state, or local government employee plan. Category excludes military pensions.

private employer-sponsored coverage reported among recent retirees (and, conversely, their relatively low rate of public-plan coverage). Among covered retirees age 75 or older, 44 percent had coverage sponsored by a private employer, and 31 percent had coverage from a public employer plan. By comparison, among younger retirees (age 65-69), at least 55 percent of all retirees with coverage from a past employer apparently had their coverage from a private employer plan; 28 percent had public-employer sponsored coverage.

While most retirees receive some contribution to the cost of their plan (a characteristic of private and public plans that is clear from the BLS data on active workers' plans described earlier), an important minority report that they pay the full cost of coverage themselves, with no sponsor contribution. In 1984, nearly 22 percent of all retirees paid the full cost of coverage without a sponsor contribution; among retirees age 65 or older, 23 percent paid the full cost of coverage (see Table 7). Conversely, for nearly 39 percent of retirees with health insurance from a past employer, the plan sponsor paid the full cost of coverage.

The likelihood that the plan sponsor contributes all or part of the cost of coverage is substantially higher among retirees with coverage from a private plan compared to those with public-plan coverage, an observation also consistent with the reported features of active worker plans. Among both early retirees (age 55 to 64) and retirees age 65 or older with private plan coverage, approximately one-half (49 percent and 51 percent, respectively) had their coverage fully paid by the plan sponsor.² By comparison, about

²Because retirees in plans for whom the plan sponsor was indeterminable are excluded, the percent of retirees in private plans with coverage that is fully paid by the plan sponsor may be biased upward slightly.

Table 7
 People Age 55 or Older with Retiree Health Insurance
 by Level of Retiree Contribution to Coverage,
 Type of Pension Plan Sponsor, and Retiree Age, 1984

	Number of retirees with benefit (in millions)	Share of plan cost paid by retiree:		
		All	Part	None
		(percent of participants)		
All retirees	11.3	21.9%	39.3%	38.8%
<u>Age 55-64:</u>				
Total	3.8	19.3	42.2	38.5
Pension sponsor:				
Private	2.0	14.3	36.4	49.3
Public	1.1	19.1	60.2	20.7
Not reported	0.8	33.4	29.6	37.1
<u>Age 65+:</u>				
Total	7.6	23.2	37.9	38.9
Pension sponsor:				
Private	3.9	14.8	34.0	51.2
Public	2.2	22.4	54.4	23.3
Not reported	1.7	44.3	23.8	31.9

Source: Preliminary EBRI tabulations of the Survey of Income and Program Participation, matched Waves 2 through 5 (U.S. Department of Commerce, Bureau of the Census).

Note: Data omit individuals living in households that were not interviewed at any time during the calendar year. Items may not add to totals because of rounding.

one-quarter of retirees with coverage from a public employer (23 percent) had the full cost of coverage paid by the plan sponsor.

Employer Liability for Retiree Benefits

Revised estimates of private and public employer liability for retiree health insurance benefits are reported in Table 8. Although these estimates are reported together, they are of public policy interest for very different reasons. In particular, private employers are confronting the prospect of new accounting rules that would require them to recognize on their balance sheets liability for benefit obligations to retirees and, potentially, benefit promises made to current workers. Virtually all of this liability is, at present, unfunded. Amortized and reported over some allowable period, this liability would offset corporation income and, consequently, reduce reported profit. Because these liabilities are unevenly distributed, even among employers with retiree health plans, a realignment of relative corporate profits will probably ensue. If, as seems likely, equity markets have not fully anticipated the retiree health benefit liability of individual corporations, the realignment of corporate profitability would produce an adjustment in the relative value of corporate stocks.

The issues associated with public employer liability for retiree health insurance are somewhat different. Public-employer liabilities represent a claim against future tax dollars. The current cost of state and local government obligations for retiree health benefits directly affects their operating budgets and poses an increasing strain on fiscal management. Most states and municipalities are required to balance their budgets annually.

Table 8
 Private and Public-Employer Liability for Retiree Health Insurance Benefits:
 Intermediate Estimate, Discounted Present Value, 1988^a
 (dollars, in billions)

Worker/Retiree Status	Private Employers	Public Employers	Total
Current retirees	\$ 68.2	\$ 23.0	\$ 91.2
Current workers	100.5	87.7	188.2
Total, retirees and current workers	168.7	110.7	279.4

Source: Employee Benefit Research Institute, preliminary estimate.

^aEstimates include reductions in plan cost as a result of recent legislation expanding Medicare benefits. On average, corporate and public-employer liabilities are estimated to decline by approximately 30 percent as a result of new Medicare benefits.

We estimate that the present value of private employers' liability for retiree health insurance obligations is approximately \$169 billion. Most of this liability, nearly \$101 billion, is associated with current workers. The present value of corporate liability for current retirees is slightly more than \$68 billion.

These estimates are low relative to those that have been presented by other researchers, and substantially lower than the trillion-dollar estimates that have been reported by the press. The single major reason that these estimates appear relatively low is that they include a downward adjustment for recent legislation expanding Medicare benefits.

The value of the new Medicare benefits to plan sponsors can vary radically from plan to plan, depending on the plan provisions, the Medicare assignment rate among physicians in the areas where retirees live, and a host of other factors. Our estimates assume that the new Medicare coverage reduces employer plan costs by 10 percent in 1990, 40 percent in 1991, 45 percent in 1992, and 50 percent in subsequent years. This assumption, applied to both private and public plans, reduces estimated liability by approximately 30 percent. Without this adjustment, we estimate that the present value of private, corporate liability for retiree health benefits would be \$247 billion: \$98 billion for current retirees, and \$149 billion for current workers.

A second major assumption implicit in our estimates is the projected rate of inflation in health care services. The estimates reported here assume that

health care cost inflation continues to exceed general inflation, but that the difference between the rates declines incrementally over the next 25 years. The rates of inflation are assumed to converge (at 5 percent per year) when aggregate spending for health care services reaches 22 percent of GNP.

Calculating the annual cost to amortize employer obligations over some hypothetical period is fairly simple, and produces some idea of the current cost that funding retiree health benefit liabilities may pose for corporations aggregately. Assuming that employers are able to amortize unfunded liabilities for current retirees over fifteen years, aggregate annual cost would be approximately \$7.4 billion. This cost alone could represent a substantial increase in annual corporate spending for health insurance benefits -- 10 percent or more for corporations that sponsor these plans. If employers were to amortize the full cost of retiree health liabilities for both retirees and current workers, the annual cost could exceed \$18 billion. This annual cost could raise annual spending for health insurance benefits by more than 25 percent for corporations that sponsor retiree health benefits.

Concluding remarks

The issues surrounding the retiree health insurance benefits provided by private corporations and public employers are difficult and complex. They fundamentally include retirees' economic well-being and, respectively, corporate financial stability and public-sector budgeting. New accounting rules are likely to make urgent the consideration of tax relief to facilitate funding of corporate liabilities. We congratulate the Committee for focusing on these issues early, and stand ready to assist the Congress by providing

data and analysis to inform their debate.

References

- Chollet, D.J. and R.B. Friedland, "Employer-Paid Retiree Health Insurance: History and Prospects for Growth," in F.B. McArdle, ed., The Changing Health Care Market (Washington, D.C.: Employee Benefit Research Institute, 1987).
- U.S. Department of Labor, Bureau of Labor Statistics, Employee Benefits in Medium and Large Firms, 1986, Bulletin 2281 (Washington, D.C.: U.S. Government Printing Office, June 1987), Tables 29 and 30.