



Appendix I

Employee Benefit Research Institute

Questions and Answers

Regarding

The Reagan Tax Reform Package

May 29, 1985

07/16/85

EMPLOYEE BENEFIT RESEARCH INSTITUTE

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Contents

	<u>Page</u>
Q1: Employee benefits have gotten a lot of publicity since Treasury One was released in November. How many workers actually have employee benefits?	1
Q2: Treasury One proposed a cap on the amount of health insurance that could be provided tax free. The Reagan package replaces this "cap" with what has been referred to as a "floor." How do the effects of these proposals differ?	1
Q3: Does the availability and cost of health insurance vary by state?	2
Q4: How much is spent on health insurance?	4
Q5: The Reagan package would also change the tax provisions for IRA and so-called 401(k) programs that allow workers to set aside funds pre-tax until they withdraw them. How many people have both an IRA and a 401(k) plan?	4
Q6: Do you have a better breakdown on how dual IRA and 401(k) use varies by income?	6
Q7: How much do employees with 401(k) plans actually contribute?	7
Q8: How many employers "match" the employee 401(k) contribution?	8
Q9: The Reagan package would tighten the loan provisions and eliminate hardship withdrawal provisions of 401(k) plans. How many plans have these provisions?	8
Q10: Are such provisions important to encourage 401(k) plan participation?	8
Q11: How many 401(k) plans are there and how many people participate in them?	8
Q12: The Reagan package would allow nonworking spouses to put more into an an IRA. How many persons would this affect?	8

Q1: Employee benefits have gotten a lot of publicity since Treasury One was released in November. How many workers actually have employee benefits?

A1: Out of approximately 88 million non-agricultural employees in 1983:

Health Insurance- 162 million persons at all ages with primary or secondary; 82 million workers with primary or secondary; and 62 million workers with primary coverage

Life Insurance- 72 million persons

Disability Insurance- 51 million

Dental/Vision-- 30 million

Dependent Care- 2 million

Group Legal--2 million

Educational Assistance- 5 million

Cafeteria or Section 125 plans- EBRI estimate is 5 million--ECFC estimate 5.4 million

401(k) plans- EBRI estimate is 19 million

Retirement plan participants affected by distribution rule changes- 40 million (some in more than one plan)

Pension plan participants in at least one plan--56 million

Q2: Treasury One proposed a cap on the amount of health insurance that could be provided tax free. The Reagan package replaces this "cap" with what has been referred to as a "floor." How do the effects of these proposals differ?

A2: The two proposals can be compared against a number of factors:

1. Revenues: The "cap" was indexed to the CPI, yet it still would have affected more persons each year since health inflation has exceeded general inflation. In order for the "floor" to raise the same amount of revenue it would also have to be indexed. Table 1 shows the future increases that would be necessary to raise the same amount of revenue over time.

Both the "cap" and "floor" revenue estimates are based on current marginal tax rates. By substantially lowering marginal rates, comprehensive tax reform as proposed would greatly reduce projected revenues from the taxation of health insurance in all projection years.

2. Equity: The "cap" based taxation on the expense of the health insurance provided. This meant that persons with limited coverage would probably pay no tax, while those with generous coverage probably would. The "floor" is equivalent to a head tax providing that anyone with health insurance would pay tax regardless of the economic value of their insurance.

Table 1
PROJECTED TAX CAP REVENUES
AND EQUAL-REVENUE LEVELS OF A TAX FLOOR

	1987	1988	1989	1990
Tax Cap Revenue Estimates <u>a/</u> (in billions)	\$ 4.6	\$ 8.0	\$ 9.8	\$11.9
Equal-Revenue Tax Floor (monthly contribution)	\$25	\$42	\$52	\$63

SOURCE: U.S. Department of the Treasury; and the Employee Benefit Research Institute.

a/ Based on a monthly tax exemption limit of \$70 for individual coverage and \$175 for family coverage.

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3. Health Care Cost Containment: A tax floor is potentially inflationary, since it is simple to offset workers' greater tax liability by reducing the out-of-pocket spending associated with the plan (that is, lowering deductibles, copayments, or employee premium contributions). Given a tax floor, employees could bargain higher benefits without tax implications.

4. Administration: The "floor" has administrative ease. A "cap" could represent major problems for experience-rated plans, self-insured plans, and groups like construction trade unions, where many different employers contribute to coverage during the year. Since all workers with an employer contribution would predictably pay on the full amount of employer contributions under the floor, computing additional taxable income would be greatly simplified.

5. Persons Affected: Table 2 compares the number of people affected by the "cap" and "floor" and the relative tax burdens.

Q3: Does the availability and cost of health insurance vary by state?

A3: Yes. Significantly. Table 3 shows that coverage ranges from 66.4 percent to 37.6 percent among states. Table 4 shows cost variation for public employees of from less than \$50 (Virgin Islands) to over \$300 (Michigan) per month.

Table 2

PERCENT OF HOUSEHOLDS (PERSONS) AFFECTED
BY A TAX CAP VS. A TAX FLOOR
ON EMPLOYEE HEALTH INSURANCE BENEFITS

Annual Family Income	\$1800 Tax "Cap"		\$300 Tax "Floor" a/	
	Percent of Households Affected	Average Additional Taxes as a Percent of Income	Percent of Persons Affected <u>b/</u> (number)	Average Additional Taxes as a Percent of Income
\$ 0 - \$10,000	2	2.76	18(4.4m)	0.2
10,001 - 15,000	9	1.34	52(11.7m)	0.4
15,001 - 20,000	14	0.84	64(14.4m)	0.3
20,001 - 30,000	23	0.76	77(34.4m)	0.3
30,001 - 50,000	33	0.68	83(41.9m)	0.2
50,000 +	35	0.43	82(18.9m)	0.1
Total	na	na	(125.7m) (64.1m workers)	na

SOURCE: U.S. Congress, Congressional Budget Office, "Containing Medical Care Costs Through Market Forces" (May 1982), p. 36; and EBRI estimates from the Current Population Survey (U.S. Department of Commerce, Bureau of the Census).

a/ Assumes a \$25/month uniform "floor". The Reagan \$10/\$25 would affect as many persons, but the tax liabilities would be lower.

b/ Includes all persons living in families with the indicated level of family income.

Table 3: Percentage Of Workers With Health Insurance Coverage, 1983

Rank	State	Percentage	Rank	State	Percentage	Rank	State	Percentage
1	Nevada	66.4	18	Wisconsin	60.8	34	Alaska	55.0
2	Delaware	66.0	19	California	60.6	35	Kansas	55.0
3	Illinois	65.8	20	Kentucky	60.0	36	Alabama	54.8
4	New York	65.6	21	Rhode Island	60.0	37	Utah	53.6
5	Pennsylvania	64.5		U.S. Average	59.7	38	Washington	52.8
6	New Jersey	64.3	22	Georgia	59.6	39	Colorado	52.4
7	Ohio	64.1	23	Oregon	59.3	40	Florida	51.8
8	Connecticut	63.1	24	New Hampshire	59.1	41	Minnesota	51.2
9	Massachusetts	63.0	25	Idaho	58.9	42	New Mexico	51.1
10	North Carolina	63.0	26	South Carolina	58.7	43	Iowa	49.7
11	Tennessee	62.7	27	Texas	57.5	44	Nebraska	49.2
12	Hawaii	62.4	28	Mississippi	57.1	45	Wyoming	48.7
13	Maryland	62.1	29	Maine	56.8	46	Arkansas	48.3
14	Indiana	61.4	30	Vermont	56.8	47	Oklahoma	48.1
15	Virginia	61.2	31	Louisiana	56.7	48	South Dakota	45.9
16	Michigan	61.0	32	Arizona	56.1	49	North Dakota	41.2
17	West Virginia	61.0	33	Missouri	56.1	50	Montana	37.6

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Q4: How much is spent on health insurance?

A4: The average health insurance premium for private firms:

greater than 1,000 employees = \$142 per month
 1,000 to 10,000 employees = \$139 per month
 greater than 10,000 employees = \$128 per month

single coverage for med/lg firms = \$76 per month
 single coverage for small firms = \$90 per month

Q5: The Reagan package would also change the tax provisions for IRA and so-called 401(k) programs that allow workers to set aside funds pre-tax until they withdraw them. How many people have both an IRA and a 401(k) plan?

A5: Table 5 sets out statistics on those with both types of programs. Approximately 6 percent (711,565 out of 11,949,000) of all those with an IRA also contributed to a 401(k)? Approximately 37.5 percent (711,565 of 1,895,000) of those who contributed to a 401(k) also contributed to an IRA.

Table 4

MONTHLY CONTRIBUTIONS TO STATE EMPLOYEE HEALTH INSURANCE PLANS: 1983 AND 1984

	EMPLOYEE COVERAGE ONLY				EMPLOYEE AND FAMILY COVERAGE			
	Cost To Employee		Cost To State		Cost To Employee		Cost To State	
	1983	1984	1983	1984	1983	1984	1983	1984
Alabama	0	0	75.00	94.32	65.00	77.00	75.00	94.32
Alaska	0	0	165.70	184.57	0	0	165.70	184.57
Arizona	1.00	1.00	55.56	67.90	50.90	61.44	104.74	128.14
Arkansas	17.38	20.84	41.00	48.00	33.06	44.74	41.00	48.00
California	1.38	9.19	71.00	76.00	20.08	30.97	168.00	185.00
Colorado	22.16	12.00	42.12	53.12	117.81	121.00	42.12	53.12
Connecticut	0	0	60.88	79.98	41.22	20.01	93.68	86.68
Delaware	0	0	56.08	64.32	0	0	137.92	158.18
Florida	14.46	18.92	56.08	64.32	34.76	40.74	137.92	158.18
Georgia	13.28	15.18	39.88	65.20	48.46	55.64	75.06	122.80
Illinois	10.00	13.10	51.10	56.20	30.00	39.30	93.90	101.65
Indiana	15.98	15.98	15.98	15.98	49.14	72.46	49.14	49.14
Iowa	0	0	73.10	73.10	66.74	66.74	73.10	73.10
Kansas	0	0	67.10	75.56	79.44	76.44	74.10	82.56
Kentucky	1.58	1.58	56.64	62.88	36.66	36.66	129.63	150.37
Louisiana	15.64	19.60	66.00	71.32	130.02	138.76	66.00	80.14
Maine	0	0	66.70	84.78	112.64	139.71	66.70	84.78
Maryland	0	0	46.10	49.00	69.26	73.66	46.10	49.00
Massachusetts	26.92	34.52	16.92	39.52	63.04	50.96	63.04	90.96
Michigan	0	0	58.10	67.08	42.28	48.58	104.04	119.66
Minnesota	5.68	10.20	11.10	57.88	16.20	29.08	145.84	164.82
Mississippi	6.12	11.12	55.16	63.00	17.86	32.60	160.80	185.92
Missouri	11.56	10.19	69.03	85.03	24.00	21.38	143.04	178.46
Montana	8.45	10.38	76.01	93.41	23.66	29.07	212.90	261.67
Nebraska	0	0	61.20	69.50	7.74	8.50	130.84	146.00
Nevada	0	0	26.80	48.80	45.18	65.00	28.80	48.80
New Hampshire	0	0	14.00	64.00	78.00	109.00	54.00	64.00
New Jersey	0	0	69.83	71.00	46.76	41.00	80.00	90.00
New Mexico	0	0	26.82	38.05	0	0	166.75	136.24
New York	4.66	10.97	29.82	41.02	16.69	39.29	106.75	146.88
North Carolina	0	0	56.25	103.50	81.25	97.58	86.25	103.50
North Dakota	0	0	58.67	50.33	0	0	158.41	157.09
Ohio	0	0	41.53	51.38	0	0	102.46	135.44
Oklahoma	15.15	19.57	23.57	29.34	28.90	35.74	43.33	53.60
Oregon	19.84	25.29	19.34	37.93	50.62	65.79	25.92	98.67
Pennsylvania	0	0	44.43	44.84	5.22	0	116.49	120.54
Rhode Island	5.92	7.76	53.24	69.88	27.00	31.55	116.49	141.25
South Carolina	0	0	47.80	47.80	76.98	76.98	47.80	47.80
South Dakota	0	0	42.69	50.00	--	0	--	140.00
Tennessee	21.99	25.50	59.45	68.95	27.87	22.00	107.07	140.00
Texas	0	0	79.71	100.26	51.94	61.13	140.92	165.27
Utah	0	0	48.18	51.31	80.00	108.00	78.51	100.26
Vermont	0	0	40.16	49.17	0	0	113.55	120.62
Virginia	0	0	55.83	64.58	0	0	146.74	175.21
Washington	0	0	45.25	52.28	0	0	118.44	137.49
West Virginia	0	0	45.28	50.37	57.12	57.12	45.28	50.37
Wisconsin	6.56	6.56	45.28	50.37	67.38	67.38	45.28	50.37
Wyoming	0	0	43.98	49.36	90.08	110.84	43.98	49.36
Virgin Islands	14.00	17.45	21.00	40.71	39.00	43.56	58.50	101.64
	0	0	42.84	66.73	142.85	142.33	60.00	72.00
	15.68	7.89	60.00	72.00				
	11.24	7.37	45.00	66.30	29.70	19.50	118.86	175.33
	10.88	13.41	32.66	40.22	30.21	37.21	90.63	111.64
	0	0	67.80	77.80	50.00	62.40	122.64	146.24
	0	0	111.30	130.30	0	0	111.30	130.30
	0	0	65.00	78.00	0	0	149.00	178.00
	7.29	7.64	65.57	69.69	18.01	18.82	162.03	169.34
	11.88	24.16	70.00	70.00	93.40	117.92	70.00	70.00
	8.37	9.36	25.08	28.06	41.28	44.15	25.08	28.06

Table 5

401(k) AND IRAs

	Private Wkrs	Tot 401(k) Cont	Avg	Tot IRA Cont	Avg
Total	711,565(100%)	\$1.2 bil	\$1,710	\$1.2 bil	\$1,642
1-20,000	161,689(23%)	\$.2 bil	\$1,227	\$.2 bil	\$1,320
20,000-25,000	89,780(13%)	.06	652	.14	1,530
25,000-30,000	91,755(13%)	.09	1,537	.16	1,780
30,000-50,000	204,946(29%)	.5	2,358	.36	1,730
over 50,000	111,663(22%)	.3	2,261	.23	2,020

Q6: Do you have a better breakdown on how dual IRA and 401(k) use varies by income.

A6: Yes. Table 6 presents that information. Dual use is very much a function of income.

Table 6

401(k) AND IRA USE BY INCOME

<u>Earnings</u>	<u>% of 401(k)/IRA</u>	<u>% 401(k) Ele/both</u>
1-20,000	27%	(.27x.3 =.08)
20-25	29%	(.29x.4 =.12)
25-30	35%	(.35x.45 =.16)
30-50	48%	(.48x.52 =.25)
over 50	66%	(.66x.62 =.41)

Q7: How much do employees with 401(k) plans actually contribute?

A7: This also varies by income level. Table 7 provides national data from an EBRI survey for tax year 1982. This is the only national data available.

the lower earning 2/3 of workers contribute an average of 4.89 percent

0-10k average would be \$489
68 percent report 325 to 699 and 42 percent report 1200 to 2000

25-30k average would be \$1,222
68 percent report 2,000 or less

07/16/85

Table 7

NON-AG WAGE & SALARY 1983 401K CONTRIBUTION AMOUNTS
401K USERS: Total

	WAGE & SALARY EARNERS (PRIVATE ONLY)										NA	
	Total	ANNUALIZED AMOUNT DEDUCTED FOR 401K										
		UNDER \$325	\$325-699	\$700-1199	\$1200-1999	\$2000-3999	\$4000-5999	\$6000+				
Total.....	1,886,819	69,931	488,474	250,329	550,822	278,169	30,696	56,441	161,958			
Percent.....	100.00	3.71	25.89	13.27	29.19	14.74	1.63	2.99	8.58			
DONT KNOW.....	75,320	5,160	23,289	2,562	19,472	23,270	-	-	1,567			
Percent.....	100.00	6.85	30.92	3.40	25.85	30.89	-	-	2.08			
1-4,999.....	10,701	-	6,166	-	4,535	-	-	-	-			
Percent.....	100.00	-	57.62	-	42.38	-	-	-	-			
5,000-9,999.....	76,468	885	52,418	3,444	10,786	4,632	-	-	4,303			
Percent.....	100.00	1.16	68.55	4.50	14.11	6.06	-	-	5.63			
10,000-14,999.....	229,231	12,267	113,922	18,381	48,065	14,865	-	-	21,732			
Percent.....	100.00	5.35	49.70	8.02	20.97	6.48	-	-	9.48			
15,000-19,999.....	318,349	9,629	99,513	57,677	92,922	36,704	3,861	-	18,045			
Percent.....	100.00	3.02	31.26	18.12	29.19	11.53	1.21	-	5.67			
20,000-24,999.....	308,079	8,432	88,126	79,498	74,613	18,556	2,587	4,620	31,648			
Percent.....	100.00	2.74	28.61	25.80	24.22	6.02	.84	1.50	10.27			
25,000-29,999.....	260,245	23,379	35,421	42,266	99,450	41,044	3,918	-	14,767			
Percent.....	100.00	8.98	13.61	16.24	38.21	15.77	1.51	-	5.67			
30,000-49,999.....	437,010	3,920	64,710	30,813	163,100	111,405	14,734	17,675	30,654			
Percent.....	100.00	.90	14.81	7.05	37.32	25.49	3.37	4.04	7.01			
50,000+.....	171,415	6,260	4,908	15,689	37,879	27,694	5,596	34,146	39,243			
Percent.....	100.00	3.65	2.86	9.15	22.10	16.16	3.26	19.92	22.89			

See footnotes at end of table.

the upper earning 1/3 of workers contribute an average of 6.46 percent

over 50k

average would be \$3,230

83 percent contributed less than this amount

Q8: How many employers "match" the employee 401(k) contribution?

A8: 84 percent (Hewitt Survey)

Q9: The Reagan package would tighten the loan and eliminate hardship withdrawal provisions of 401(k) plans. How many plans have these provisions?

A9: Loan provisions are in 35 percent and hardship provisions in 87 percent (Hewitt Survey).

Q10: Are such provisions important to encourage 401(k) plan participation?

A10: A Hewitt survey shows no significant variation in participation or amounts contributed based upon plan provisions.

Q11: How many 401(k) plans are there and how many people participate in them?

A11: EBRI's May 1983 CPS survey indicated 4.8 million workers were offered plans with 39.31 percent participating in them. There has been significant new plan creation since that time, and employers report that participation rates are climbing.

A recent ECFC survey estimates 20.8 million as of May 1985.

Q12: The Reagan package would allow non-working spouses to put more into an IRA. How many persons would this affect?

A12: Table 8 provides this information by earnings for those with IRAs in tax year 1982. About 3 million persons with IRAs could have established a spousal IRA. Approximately 33 million families could have a spousal IRA if they had a primary IRA.

Table 8

IRA AND SPOUSAL IRA PARTICIPATION IN 1982
NONAGRICULTURAL WAGE AND SALARY WORKERS
PERCENTAGE DISTRIBUTION WITHIN EARNINGS GROUPS
AND CUMULATIVE DISTRIBUTION ACROSS EARNINGS GROUPS

	<u>Percentage Distribution Within Earnings Groups</u>			
	Employ- ment	% of employed with IRA	Eligible for Spousal IRA	% Contri- buting of Eligible
<u>Total Nonfarm Employees</u> (000's)	88,214	14,972	2,988	1,718
\$1-4,999	100.0%	6.7%	a/	a/
\$5,000-9,999	100.0	8.1	100.0%	a/
\$10,000-14,999	100.0	10.7	100.0	36.1%
\$15,000-19,999	100.0	17.2	100.0	49.1
\$20,000-24,999	100.0	19.9	100.0	62.5
\$25,000-29,999	100.0	28.6	100.0	50.5
\$30,000-49,999	100.0	38.7	100.0	66.6
\$50,000 and over	100.0	59.2	100.0	77.4
Total Earnings	100.0%	17.0%	100.0%	57.5%
	<u>Cumulative Distribution across Earnings Groups</u>			
	Employ- ment	IRA Contri- butions	Eligible for Spousal IRA Contributes to IRA	Established Spousal IRA
less than \$5,000	12.5%	5.1%	2.9%	a/
less than \$10,000	31.6	14.5	8.0	5.4%
less than \$15,000	53.8	28.9	17.5	11.3
less than \$20,000	70.1	46.0	31.9	23.6
less than \$25,000	82.9	61.5	47.5	40.4
less than \$30,000	89.8	73.4	60.4	51.6
less than \$50,000	98.0	92.8	84.9	79.8
Total Earnings	100.0%	100.0%	100.0%	100.0%

SOURCE: Employee Benefit Research Institute tabulations of the May 1983 EBRI/HHS CPS Pension Supplement.

a/ Numbers of workers too small for rates to be calculated reliably.

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Appendix II

Employee Benefit Expenditures

07/16/85

EMPLOYEE BENEFIT RESEARCH INSTITUTE

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EMPLOYEE BENEFITS IN VARIOUS INDUSTRIES

To produce reliable estimates of the effects of alternative limits on employee benefits, it would be necessary to have data on the value of employee benefit packages at various income levels. Such data are not available. Instead, estimates of the effects of alternative tax caps have to rely on benefits provided to the average worker in various industries. If employee benefits vary little within industries, the effect on the average worker in an industry is a good measure of the effects on the industry as a whole. If they vary considerably, data on the average worker provide only a rough measure of the industry effects.

The value of benefits per worker varies considerably across industries. According to Department of Commerce data on the entire work force, the average U.S. worker received \$2,031 in voluntary or discretionary employer benefit contributions in 1983 (Table 1). Industry totals ranged from \$646 per worker in agriculture and \$926 in retail trade--about half or less of the national average--to \$7,342 per worker in communication, or more than three and one-half times the national average. The lower an industry's average annual wages and salaries, the lower also the value of its benefit package. Agriculture, retail trade, and services are the lowest-paid sectors of the economy; these sectors also provide the lowest benefits per worker. Communication and public utilities, in turn, are two of the highest-paying sectors and also provide the highest benefits.

The share of compensation provided as voluntary employee benefits also varies widely. Voluntary benefits provided range from 5 percent of total compensation in agriculture and 6 percent in retail trade to 17 percent in public utilities and 20 percent in communication (Table 2).

Both the highest- and the lowest-benefit industries employ relatively few workers. As a result, focusing on benefits in these industries tends to distort comparisons. The range of benefits in the four largest industries is somewhat narrower. Manufacturing, retail trade, services, and government together employed 64.1 million full-time equivalent workers in 1983, or 75 percent of the work force. Voluntary benefits in these industries ranged from 6 percent of compensation in services to 13 percent in manufacturing.

The Commerce Department data cannot be used to assign benefits by type to such individuals in different industries, but the Chamber of Commerce publishes data for the firms in its sample. The average employee in the Chamber sample receives \$1,340 per year in employer contributions to pension, thrift, and profit-sharing plans, or 5.2 percent of total compensation (Table 3). The average employer contribution to health and welfare plans is \$1,736 per year, or 6.8 percent of the average employee's compensation. For most employees in the Chamber sample, health and welfare plan contributions are larger than contributions to pension and profit-sharing plans. Only in public utilities and banks and other financial institutions are health and welfare plan contributions smaller than contributions to retirement and savings programs. Employer contributions to health and welfare programs vary somewhat less across industries than do contributions to retirement and savings programs.

Table 1

WAGES AND SALARIES, BENEFITS, AND EMPLOYMENT
BY INDUSTRY, 1983

Industry	Average Annual Wages and Salaries	Average Annual Employer <u>Benefit Outlays</u>		Total Benefits as Percent of Compensation	Full-Time Equivalent Employees (in millions)
		Mandatory	Voluntary		
Agriculture, forestry, fisheries	\$11,014	878	646	12%	1.5
Mining	29,973	2,104	3,951	17	0.9
Construction	21,968	1,924	1,680	14	3.7
Manufacturing	22,170	1,713	3,649	20	17.8
Transportation	24,292	2,385	3,067	18	2.6
Communication	27,647	1,915	7,342	25	1.3
Public Utilities	28,570	2,123	6,319	22	0.8
Wholesale trade	22,687	1,708	1,897	14	5.0
Retail trade	12,914	1,050	926	13	12.5
Finance, insurance, real estate	20,725	1,472	2,827	17	5.3
Services	17,220	1,196	1,431	13	17.2
Government	20,263	962	2,985	16	16.2
All industries	\$19,460	1,797	2,031	16%	85.2

SOURCE: EBRI calculations based on U.S. Department of Commerce, Bureau of Economic Analysis, Survey of Current Business, July 1984.

Table 2
 BENEFITS AS A SHARE OF TOTAL COMPENSATION^a

Industry	Mandated	Voluntary	Total
Agriculture, forestry, fisheries	7	5	12
Mining	6	11	17
Construction	8	7	14
Manufacturing	6	13	20
Transportation	8	10	18
Communication	5	20	25
Public Utilities	6	17	22
Wholesale trade	6	7	14
Retail trade	7	6	13
Finance, insurance, real estate	6	11	17
Services	6	7	13
Government	4	12	16
All industries	8	9	16

Source: EBRI calculations based on U.S. Department of Commerce, Bureau of Economic Analysis, Survey of Current Business, July 1984.

^a Detail may not add to totals due to rounding.

TABLE 3
 EMPLOYER BENEFIT OUTLAYS PER EMPLOYEE,
 BY INDUSTRY, 1983^a

Industry	Average Wages and Salaries	Legally Required Payments	Pensions Thrift and Profit-Sharing	Health and Welfare
Manufacturing	\$20,938	\$2,124	\$1,267	\$2,046
Public Utilities	25,347	2,030	2,399	2,047
Department stores	11,701	1,122	312	618
Trade (wholesale and other retail)	17,095	1,501	727	1,047
Banks and other financial in- situations	17,641	1,438	1,282	1,047
Insurance	19,089	1,473	1,315	1,533
Hospitals	18,034	1,375	752	1,163
Miscellaneous	22,912	1,890	1,501	1,591
All industries	\$20,704	\$1,859	\$1,340	\$1,736

SOURCE: EBRI calculations based on U.S. Chamber of Commerce, Employee Benefits 1983 (Washington, D.C.: 1984), table 8.

^aPer full-time employee.

This is probably due to the fact that health insurance premiums, which make up the largest portion of health and welfare plan contributions, do not vary by income. In contrast, retirement programs, which aim to replace a share of preretirement income, are generally based on income-related formulas.

ALTERNATIVE WAYS TO SET LIMITS ON BENEFIT GROWTH

Limits on benefit growth could be set as a dollar figure or as a percent of compensation. Either method, in turn, could set one limit on all benefits or could set separate limits on various benefits.

General Considerations

A cap on benefits that was set high enough to affect relatively few employees could increase incentives to employers to contain benefit costs, as employers and employees would probably try not to let benefit costs approach the limit. By the same token, however, it is possible that such a cap would become a target for employees in firms with lower benefits. If it became a target, then total benefit costs would probably grow considerably before stabilizing at the level of the cap.

Benefits vary by industry, and they would vary even more if all industries were staffed by the same type of work force. The concept of a cap on employee benefits implies that a dollar of spending on benefits has the same value regardless of how, where, and on whom it is spent. Because benefit costs differ across industries, geographic locations, and even employees, the same dollar will instead buy very different amounts of benefits for different people. This can be illustrated by comparing the hypothetical benefit costs for a sample of Fortune 500 firms under their current benefit plans but calculated as if all the firms had the same work force (see IB #37). Even in this relatively homogeneous group of large firms, hypothetical voluntary benefit costs range from 12.5 percent of total compensation to 29.0 percent, compared with a range of 5 to 20 percent in the economy as a whole. Interindustry differences in benefit costs can arise from several causes. Industries that are physically dangerous will incur higher costs for life, disability, and health insurance. Declining industries, which tend to have a high proportion of older workers, will likewise have high benefit costs.

Dollar Limits On Benefit Contributions

Dollar limits on benefit contributions per employee would provide the same ceiling on benefits for all income groups. As a result, tax-free or tax-preferred benefits would become a smaller share of total income as income rises. This is already true of health insurance, since the cost of providing a given level of coverage for an individual does not vary with the individual's income level. Insurance premiums vary with the type of coverage provided, with the firm's location, and with the age distribution of its work force. If coverage levels did not change in response to the cap, imposing a dollar cap on benefits like health insurance could be regressive because of this lack of variation with income. EBRI research has shown that if coverage levels do not change in response to a cap on employer-provided health

insurance such as that proposed by the administration, employees with incomes below \$10,000 would pay almost seven times as large a share of income in added taxes on health insurance as employees with incomes above \$100,000. Employees would be taxed according to various factors having little or nothing to do with income or ability to pay.

If the tax cap resulted instead in leaner health insurance plans, its regressivity as a revenue source could be reduced or eliminated. Evidence on the likelihood of such an effect is mixed. Research currently in progress under contract to the Department of Health and Human Services suggests that a cap of the size proposed by the administration would result in a large decrease in employer expenditures, but other studies suggest that the reduction would be much smaller.

A dollar cap would limit the income replacement potential of benefits that are keyed to the employee's income level, such as life and disability insurance and retirement and savings plans. Depending on the level of the cap and the provisions, if any, for indexing it for inflation, such a cap could reduce the incentive for employers, particularly in smaller firms, to establish new plans that offer income replacement, since the value of the benefits at higher income levels could be very small. Under a dollar cap, federal revenue losses would only grow as benefit coverage grew.

Percent of Compensation Limits on Benefit Contributions

A percentage cap on benefits would place a less stringent limit on the ability to design benefits with a specified income replacement potential. It could still, however, create some difficult valuation and implementation problems.

Percentage limits would allow benefits aimed at income replacement to continue to be keyed to income, but would probably not encourage the improvement of income replacement rates. For example, if a cap were set on the share of compensation that could be provided as pension contributions, employers wishing to provide higher-income individuals with benefits above the limit would probably continue to use so-called "excess" plans, which provide benefits through unfunded, unqualified plans which are not eligible for tax deductions. If the cap were set low enough to affect rank-and-file employees, however, employers could be discouraged from implementing benefit improvements that increase income replacement levels. Such improvements can be important in increasing benefit delivery in employer plans. For example, between 1975 and 1980, plans in 240 companies, covering 8.2 million employees, increased income replacement rates for lower-paid employees by 16 percentage points. If a cap on benefits were set low enough to affect rank-and-file employees, few employers would establish nonqualified plans for them.

While a percentage cap would not be as restrictive as a dollar cap with respect to income-replacement benefits, it would affect flat-rate benefits like health insurance much like a dollar cap. Since the cost of health insurance does not vary with income, it is a larger share of income at lower than at higher income levels. A percentage cap on health insurance could

therefore tax health insurance heavily at lower income levels while leaving it virtually untouched at higher income levels.

A Floor on Nontaxable Benefits

As an alternative to a cap beyond which benefits would be taxable, it has been suggested that a taxable "floor" could be set above which benefits would be nontaxable. Such a floor would tax all health-insurance recipients, not just those with costly plans. Such a floor would be a more reliable means of raising revenue through employee benefits than a tax cap. Employees would be able to avoid tax under a tax cap by negotiating more cost-effective plans with their employers or by reducing coverage for certain benefits. If a tax floor were implemented, however, taxes could only be avoided by dropping coverage entirely. Some employees would probably do so, but for the remainder the tax floor would be even more regressive than the tax cap since more employees would be affected. A tax floor, particularly if it were set at a relatively low level, would not encourage employers and employees to seek more cost-efficient coverage, and could instead encourage health care cost increases if employees sought richer coverage to compensate for the taxes paid below the floor.

RECENT PROPOSALS

Three specific proposals to include some part of employer contributions for benefits in taxable income have been raised before Congress.

Economist Alicia Munnell has suggested that all benefits above 15 percent of total compensation should be included in taxable income. Munnell does not differentiate between legally-mandated and voluntary benefits. This proposal thus ignores the fact that legally-mandated benefits are in fact themselves taxes levied on employers and employees. Under an overall limit, increases in the Social Security payroll tax would gradually crowd out voluntary benefits. Ultimately, this proposal would increase the burden on taxpayers of providing income security and risk protection benefits.

In a speech before the Employers Council on Flexible Compensation on February 1, 1985, Senator David Durenberger (R-MN) proposed that tax-free employer expenditures on welfare benefits (medical, dental, and legal benefits and life and disability insurance) be limited to \$2,250 per employee and \$4,000 per family. Limits on retirement benefits would continue to be set under Section 415 of the Internal Revenue Code and tax-free expenditures for child care and educational expenditures would be limited separately. While available data on per-employee benefit costs are sketchy, they suggest that these limits would affect very few people. Firms affected are most likely to be those with other work forces or located in high-cost areas. The proposal would continue to allow employers and employees considerable choice concerning the allocation of expenditures for employee benefits. The proposed treatment of life insurance and disability benefits is not clear, however. Tax-exempt life insurance is already limited by statute to \$50,000 per employee, and disability benefits are taxable upon receipt. Including these benefits under the cap would be

value of improved coverage to all workers. To maximize employee participation in the plan, and to enhance the plan's cost-efficiency, however, employee contributions to the plan are generally kept low.

Greater participation in employer health insurance plans has also been encouraged by the rising cost of individual coverage. As preferred health insurance risks (prime-age working adults and their dependents) have been absorbed into employer group plans, the cost of individual private health insurance coverage has risen. Recent changes in the tax code have further reinforced the attractiveness of employer plan participation relative to the purchase of individual coverage. While employer contributions to health insurance remain tax-exempt, the 1982 Tax Equity and Fiscal Responsibility Act (TEFRA) reduced tax preferences for individual insurance purchase, widening the disparity between the tax treatment of employer-based coverage and the purchase of individual coverage.

C. Equity--Employer group health insurance coverage is possibly the most egalitarian employee benefit provided to workers in the United States. Employer health plans include the spectrum of workers at all levels of earnings; rates of coverage among all workers except those at the very lowest annual earnings level--generally with fragmented employment patterns--are high and roughly equal. Furthermore, the value of health insurance benefits shows little variation among workers.² As a result, employer-provided health insurance is a particularly valuable benefit for low- and middle-income workers: for these workers, employer contributions to coverage represent a

² Employer contributions to health insurance, as reported in the 1977 National Medical Care Expenditures Survey, showed no significant variation by worker earnings. Gail R. Wilensky and Amy K. Taylor, "Tax Expenditures and Health Insurance: Limiting Employer-Paid Premiums," Public Health Reports (July/August, 1982), table 2.