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The Impact of ERISA

Historically, state governments have exercised a great deal of oversight and control over traditional health insurance sold within a state. However, the 1974 Employee Retirement Income Security Act (ERISA) exempts those employers who "self-insure" their health benefit plans from state regulation, taxation and control. Under these plans the employer pays the health care claims directly, rather than purchasing an insurance policy to pay claims, and thus escapes state regulation of insurance.

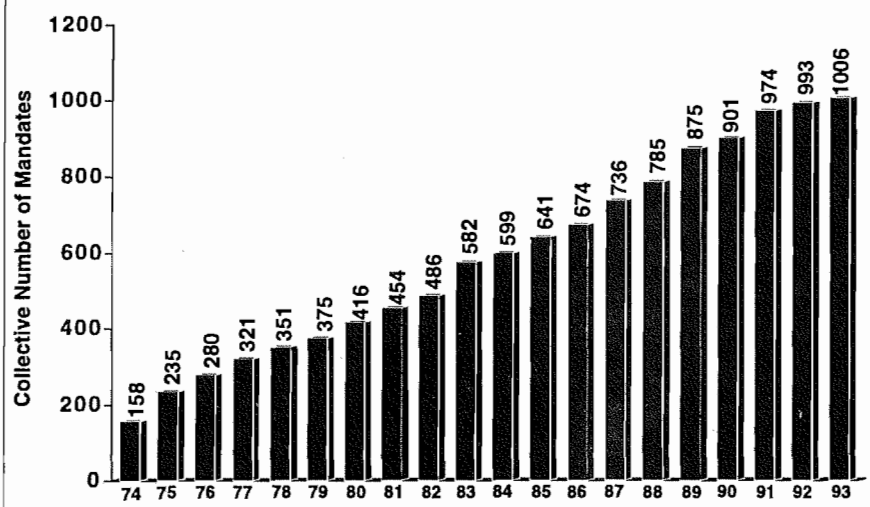
Some members of Congress now want to give states greater authority and control over those self-funded plans by giving the states "waivers" from the ERISA exemption. Such waivers would allow states to prescribe the terms of coverage for all workers, set health insurance premiums within the state and tax all employers as a way to fund the state's component of the program.

While it is clear that the ERISA exemption has led to distortions in the current health care system, giving states more control over the self-funded plans would only make matters worse. Let's see why.

Costly burdens: state mandates. Since the passage of ERISA, group health insurance in the U.S. has evolved into two separate but unequal parts — one subject to a burdensome array of state insurance regulations and the other almost regulation-free.

State regulations on employer-provided traditional insurance have ballooned. As the figure shows , the number of state-mandated benefits laws has grown to more than 1,000 from only 158 at the time ERISA was enacted. These mandates prescribe the terms of group policies, including requirements that plans cover specific services such as counseling or drug and alcohol abuse programs and providers such as chiropractors or podiatrists.

Trend in State-Mandated Health Care Benefits, 1974 - 1993



Source: *Health Benefits Letter*, February 23, 1994, pp. 8-11.

With few exceptions, and despite the claims of their proponents, such laws are not moneysavers. Studies in six states have found that mandated coverage accounts for between 7 and 21 percent of all insurance claims, depending on the state. By forcing an expansion of benefits, state regulations cause firms to incur additional insurance expenditures, which translate into higher national health care spending and lower take-home wages for employees of these firms.

Research indicates that about two-thirds of the employers who converted to self-insurance did so to avoid state regulations, while an estimated one in five small firms that are not offering health benefits would do so in an environment free of state-mandated benefits. Were those firms to begin offering plans, 6.3 million Americans (full-time workers and their dependents) would gain access to employer-sponsored coverage.

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Costly burdens: state taxes. Besides adding regulations, the states have increasingly turned to health insurance companies as a source of tax revenues to implement health insurance reforms. For example, all states levy taxes on insurance, typically 2 to 3 percent of premiums. In addition, for persons deemed uninsurable, many states have established high-risk pools that are financed through insurance taxes. Such taxes have increased the cost of private insurance and driven more and more employers to self-insurance.

The benefits of ERISA. At the enactment of ERISA, only 6 million Americans were insured through self-funded plans. Today that figure stands at 55 million, which represents 40 percent of all group coverage in the U.S. ERISA's popularity is primarily a result of the freedom it gives to employer-provided health insurance. Since federal law prohibits states from intervening in the affairs of self-funded plans, many employers have been able to tailor their health benefits to what workers want and can afford, avoid the growing burden of state-mandated benefits and escape additional state-imposed taxes on traditional insurance.

As a result, self-insured firms can attract workers with compensation packages that cost less than those offered by firms that do not self-insure. This is true despite the fact that self-insured plans typically have higher administrative costs than insured plans. Several studies have documented that premiums for self-insured plans are actually about 5 percent higher than plans containing the same coverage sold by traditional insurance companies.

Unfortunately, the self-insured plans' additional administrative costs add unnecessarily to the country's health care bill. In 1993, firms that otherwise would have purchased traditional health insurance spent an extra $6.14 billion in additional administrative costs in order to self-insure.

Yet state insurance regulations and taxes are so burdensome that, for many employers, self-funded plans are the only rational choice.

The current system is unfair. The fact that some companies are exposed to state-level mandates, taxes and controls while others are free from such regulations has created an unfair system that weakens the ability of non-self-insured firms to compete effectively against their self-insured rivals. The best way to remove such distortions is to create a level playing field in which all companies are either subject to the same regulations or exempt from them. Based on the popularity and benefits of ERISA, Congress should consider expanding it so that even smaller employers are able to self-insure.

ERISA's limitations. Initially, ERISA was intended to permit the largest employers to self-insure. However, as the burden of state mandates and state legislative intrusion into employer-provided health plans has grown, smaller and smaller employers have shifted to self-insurance, often in conjunction with a "stop loss" policy that limits the employer's losses in case one or more employees experience unusually high medical expenses.

However, the funds needed for self-insurance limit the ability of smaller firms (say, under 50 employees) to take advantage of the regulatory-free climate of ERISA. Small firms have typically viewed self-insurance as too risky, since a few unanticipated catastrophic claims could easily threaten their financial solvency. Consequently, the burden of increasing state insurance regulation has fallen, and continues to fall, disproportionately on small firms.

The case for expanding ERISA. All employers need relief from burdensome state insurance regulation and taxes. An expansion of ERISA's exemption, similar to that proposed by Rep. Harris Fawell (R-IL), to all companies purchasing health insurance would help alleviate the inefficiencies in the current system. Firms that have been unable to self-insure because of their size would gain the flexibility to design benefits that fit workers' preferences and to offer plans the workers could afford. At some firms, special coverages employees do not want would be eliminated, lowering total health care costs. In addition, uninsured small businesses would be more willing to offer basic, no-frills health insurance.

This Brief Analysis was prepared by NCPA Fellow Gail A. Jensen, Ph.D., Professor at the Institute of Gerontology at Wayne State University.

For further reading, see: *Gail A. Jensen and Jon R. Gabel, "State-Mandated Benefits and the Small Firm's Decision to Offer Coverage,"* Journal of Regulatory Economics, *Vol. 4, No. 4, December 1992; and Gail A. Jensen, Kevin D. Cotter and Michael A. Morrisey, "State Insurance Regulation and the Employer's Decision to Self-Insure,"* Journal of Risk and Insurance, *Vol. 62, No. 2, June 1995.*