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*Benefit Policy*

# The United States of Benefits: How Employee Benefits Became the Coin of the Realm

BY JASON HAMMERSLA

Fifty years ago, America was in a turbulent period of transition – culturally, politically and economically. The anti-war movement and civil rights struggles exposed deep fissures in our national identity. Lingering guerilla warfare in Asia and simmering conflict with the Soviets threatened our sense of geopolitical security. The shift from an agro-industrial age to an information economy created enormous dislocations in the labor market as well as an evolution of rising expectations.

Not much has changed.

One notable exception is the compact at the heart of American business: the bond between employer and employee. Demographic and economic disruptions have effected an evolution in this relationship and it continues to evolve in real time. Employee benefits, once seen as a tertiary element of an individual's employment, are evolving along with that relationship, rising in importance and expanding in definition. Naturally, this has created constant corporate and public policy challenges.

The past year could not have been a more appropriate time to reflect on the challenges met – and those to come. The events of the past twelve months, and the last 50 years, show that employee benefits are now the beating heart of the American economy, from Wall Street to your street.

With an eye toward the future of employee benefits, and in conjunction with its 50th anniversary, the American Benefits Council commissioned a nationwide survey of American adults in November 2017. Unsurprisingly, employer-sponsored retirement and health coverage ranked far-and-away as the two most important benefits over the next ten years.

What was more surprising – and, we presume, gratifying, for the employers who devote so much time and energy to their benefit programs – is that people prefer compensation packages that emphasize more, quality benefits over take-home pay by a nearly 2-to-1 margin. This finding flies in the face of emerging ''cash-only'' compensation philosophies and underscores the way in which health and retirement benefits have become central to the employer-employee relationship writ large.

The congressional tax reform debate is a microcosm of the legislative landscape upon which employee benefits is positioned – and a case study in the public's abiding appreciation of workplace health and retirement plans.

## Employee Benefits at Risk, From Retirement . . .

Early drafts of tax reform legislation, it was reported, featured a dramatic and highly lucrative change in the way retirement savings were taxed. Instead of allowing employees to contribute money pre-tax (and being taxed on amounts later withdrawn), the proposal would have flipped the script by requiring at least some portion of those contributions to be contributed after tax (and not being taxed on amounts withdrawn . . . theoretically).

While proponents were able to conceive policy arguments for such a change—the notion that the tax benefits inure mostly to the benefit of the well-paid was a common refrain — those arguments seemed incidental in comparison to the hundreds of billions of dollars' worth of federal revenue it was projected to raise.

The mere proposal of such a change inspired vociferous opposition from individuals and businesses – and one memorable tweet from the president.

Trump's defense of the 401(k) tax incentives was actually rooted in real-world data. According to the Council's November 2017 survey, this tax break ranked No. 1 as ''the most important tax benefit over the next ten years'' among American adults, besting other popular deductions like those for home mortgage interest and contributions to charity.

When one considers that the tax deferral on retirement plan contributions is critically important to the employer-sponsored 401(k) system, empirical research offers strong justification for public opinion. For a report to be published by the American Benefits Council

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later this year, the nonpartisan Employee Benefit Research Institute (EBRI) determined that employer-sponsored retirement plans result in a nearly 30 percent increase in the number of low-income households achieving retirement security as would be the case in the absence of such plans.

As part of the same analysis, EBRI reports that the current anticipated retirement savings shortfall – a calculation of the aggregate value of projected financial deficits in retirement for all US households between the ages of 35 and 64 – sits at just over $4 trillion (including long-term care costs), which is as good an argument as any for more opportunities to save, not fewer. But, more pointedly, that shortfall would jump to more than $7 trillion in the absence of employer-sponsored plans.

## . . . to Your Health

A similar principal is at play with respect to employer-sponsored health benefits, which has been the core of health care coverage for generations.

The federal tax incentive encouraging employers to offer health insurance coverage to their workers has often been described as an ''accident of history,'' an inadvertent byproduct of World War II wage and price controls. Today, this decision appears provident. Because the enactment of ERISA in 1974 cemented a federal framework for benefit plan administration and the Affordable Care Act of 2010 built a superstructure on the foundation of workplace coverage, the employer-sponsored system now covers more than 178 million Americans, or more than half the country.

Like workplace retirement coverage, this health coverage is made possible by that longstanding tax policy whereby employees are untaxed on the value of the coverage they receive. In the Council's November 2017 survey, the health tax exclusion finished a close second to the tax deferral on retirement plan contributions.

And, like they did with the retirement savings tax incentive, Congress seriously considered curtailing the health coverage tax exclusion in 2017 in an effort to raise federal revenue for a major legislative proposal. The tenuous assumptions underlying this proposal – that tax-favored insurance results in overconsumption of care (unproven) and its elimination would result in wage increases (purely theoretical) – have become orthodoxy in certain economic and political circles.

An early draft of the Republicans' legislation to repeal and replace the Affordable Care Act included a cap on the employee health coverage exclusion – a proposal that was a vital component of the ''Better Way'' agenda advanced by Republican lawmakers in the U.S. House of Representatives in 2016 and has been part of GOP proposals for decades.

The idea was stripped from the repeal-and-replace bill before it saw the light of day – and before voters could catch wind of it – but the intentions of some in Congress, and the contrary view of both employer and employee groups, were clear: the health coverage tax incentives are sacrosanct.

Ultimately, policymakers came to the same understanding as the majority of our survey respondents: cutting or eliminating the preferential tax treatment of employee benefits is not worth the purported increase in taxable wages.

## The Benefits Are Everywhere

It is thus that the most humbling defeat and the signature success of President Trump's first year each support the thesis that health and retirement benefits are now indelibly linked to the economic activity of individuals and the nation itself.

The United States is unique among advanced economies in the extent to which employer-sponsored benefits form the basis for health and retirement coverage. It confers a number of advantages to the greater economy, including flexibility in labor markets, lower payroll taxes, comparatively high benefit levels and growth through capital formation.

Workplace defined contribution retirement plans (such as ''401k plans'') for example, constitute more than $6 trillion in stable investment capital, with defined benefit plans (the more traditional pension plan) contributing another $3 trillion.

Beyond financial markets, an argument must be made for the profound advantages these plans offer to America's own balance sheet. Not only do employer-sponsored health and retirement benefits ultimately mitigate the cost burden on public safety-net programs such as Medicaid, Medicare and Social Security, but incentivizing employers to maintain health coverage also reduces the financial consequences to the government of providing subsidies to those individuals who could not otherwise afford coverage – or who would receive uncompensated care, the costs of which would be passed along to other payers. With respect to health care alone, our calculations suggest that for every $1 of tax expenditures in the form of the health tax exclusion, employers paid $4.61 to finance health benefits, yielding a clear bargain for the American taxpayer.

Employer plans are also better able to harness behavioral economics and innovate to improve outcomes for workers by leveraging purchasing power to pay for value, driving quality improvement, demanding technological advancements, personalizing the consumer experience and embracing disruption.

Disruption, however, is not without its own implications.

## Benefits for Everyone?

The microeconomic repercussions of this ''benefits-forward'' reality are myriad and, to some degree, unsettling. The nature of work itself is changing as technology displaces certain job functions (through robotics and artificial intelligence) and facilitates globalization (through communications tools that make the world smaller), suggesting that jobs are becoming more of a commodity even as employment – and employer-sponsored benefits – are becoming more important.

The defining employment trend of the past several years is the emergence of the so-called ''gig economy,'' which takes ''at-will'' arrangements to the extreme and typically eschews traditional benefits and social insurance in favor of direct compensation.

Alan Krueger, the Bendheim Professor of Economics and Public Policy at Princeton and former chairman of President Obama's Council of Economic Advisers, has estimated that about two-thirds of all job growth over the last decade has been the result of self-employment and contract workers.


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In anticipation of a coming need to provide benefits to that population, Senator Mark Warner (D-VA) has proposed a bill to fund experimentation with ''portable benefits programs'' that travel with the individual, regardless of where they work.

Without commenting on the merits of that particular proposal, it is worth noting that this mode of public policy problem solving is not limited to the gig worker. In the context of broad economic disruption and federal government inaction, state and local governments have taken up efforts to extend certain kinds of employee benefits to those who lack coverage at work. This, too, illustrates the ascendant value of benefit programs while presenting real challenges for large employers.

## Altered States

The phenomenon is most directly observed in the growth of so-called ''secure choice'' retirement programs, in which states have compelled private employers to enroll workers in – and direct payroll deduction contributions to – a state-run retirement plan if those workers do not already have employer-sponsored coverage.

Five states have already enacted such legislation (California, Connecticut, Illinois, Maryland and Oregon), with three states (Massachusetts, New York, Pennsylvania) and one city (New York City) actively pursuing similar proposals. Although these state initiatives are generally intended to apply to small employers that do not sponsor a retirement plan, larger employers are likely to be swept up as well by requiring them to extend coverage to part-time, seasonal and contingent workers.

In the paid leave space, comparable efforts are even farther along, with eight states and more than 30 municipalities having implemented some kind of mandatory paid sick leave law.

Nor are health benefit programs immune from state activity. Both the Affordable Care Act and a number of legislative programs to replace it permit states to ''innovate'' and develop their own coverage mandates, tax assessments and reporting requirements.

All of these state-based initiatives share the common, laudable goal of expanding workplace benefits coverage – which we have established is valuable and perhaps crucial to long-term financial security – to underserved employee populations. Unfortunately, they also share the potential consequence of making the administration of those benefits extremely problematic.

## The Crown Jewel

It is impossible to think about the evolution of employee benefits over the last 50 years without considering the impact of ERISA. The enactment of the law in 1974 can rightly be considered a ''win-win'' for both plan participants, who received unprecedented protections from fiduciary abuse, and large multi-state employers, for whom the law's federal preemption clause provided offered stability and predictability in plan administration.

The insurrection of state-based benefit mandates threatens to erode ERISA's preemption standard, disrupting multi-state employer plans that rely upon a strong federal framework to insulate them from a state-by-state patchwork of rules and regulations.

In many ways, this question of federalism is a fundamentally American debate that stretches back to Hamilton and Jefferson and the founding of the republic. But in 1776, the entire U.S. population was about 2.5 million people, mostly farmers. Today, Fortune 500 companies alone employ more than ten times that many people, in multiple states (and countries) and crossing innumerable city and county lines. Governmental philosophy aside, it is plainly obvious today that federal solutions, developed in cooperation with employers and service providers, will be necessary to maintain a vibrant economy.

The American people themselves seem to recommend this. When we asked our November 2017 survey population who they trusted most for high-quality health care coverage or to provide opportunities to save for retirement-- state government uniformly finished last. Employers and the individual health insurance and financial services markets rose to the top, suggesting that Congress should be working with employers and experts (and each other) to resolve these challenges.

## The Ownership Society 2.0

The trust that individuals continue to place in their employers is counterbalanced by an awareness that certain roles are changing. While it is widely acknowledged that individuals, employers and government will continue to share responsibility for providing health and financial well-being well into the future, our survey data tells us that more and more decisions are moving from the board room to our dining rooms.

When it comes to paying for and securing individuals' health and financial security, Americans see the role of individuals and government entities increasing and the role for employers decreasing over the next 10 years. The trend that began with the shift from defined benefit to defined contribution plan designs has slowly unlocked something – anxiety, or confidence, or both – in the public consciousness.

How will the provision of health and retirement benefits – which has become so elemental to the employer-employee relationship and will become even more important as domestic labor markets tighten – square with the new era of personal responsibility? The answer may, again, be technological disruption.

The defining characteristic of modern technological disruption is the elimination of intermediaries. We see this in commerce, communication and financial services. As these barriers between providers and end-users fade away, individuals have more options and more control than ever before. They will therefore rely on employers for more than mere funding. They will need and desire education, access to tools and advocacy on their behalf with service providers.

## Reply Hazy, Try Again

Just as economic, social and technological disruption has brought about a decline of organized labor as the intermediary between employer and employee, it is leading employers to reevaluate their role as intermediary between employee and the open market and even driving workers to reevaluate their relationship with not just employers, but ''work'' itself.

How, or with what, will employers ultimately be replaced? And how will employers, workers and policy-

makers manage that transition? That is the question for 50 years from now – if not much sooner.
The 19th Century French painter Eugene Delacroix – a curious exemplar, indeed, of economic theory – famously said, ''We work not only to produce, but to give value to time.''

Today, the promise of employment – or, more specifically, opportunities for achieving personal health and financial security – extends beyond mere wages. ''Work'' increasingly means access to retirement savings and health care, and more abstract assets like opportunity, flexibility and security.

Employers and employee benefits have come a long way over the last 50 years. Over the next 50 years, public policy should work to ensure the health and financial well-being of the employer-sponsored system.

When the Council set out to observe its 50th anniversary, we rewrote our mission statement to emphasize our role in ''connecting public policy and private-sector solutions to shape employee benefits for the evolving global workforce.'' We'll continue to do our part to keep employee benefit matters at the top of the national agenda – because it looks like it's already there.

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