The Unique Value of Employer-Sponsored Benefits
November 2017

The Unique Value of Employer-Sponsored Benefits represents the summary of an extensive research project undertaken in collaboration with the Employee Benefit Research Institute (EBRI). The full report will be released in early 2018.

The American Benefits Council is a Washington D.C.-based employee benefits public policy organization advocating for employers that are dedicated to the achievement of best-in-class solutions that protect and encourage the health and financial well-being of their workers, retirees and families.

The Unique Value of Employer-Sponsored Benefits was released in conjunction with the celebration of the American Benefits Council’s 50th anniversary.
INTRODUCTION

The United States is unique among advanced economies in the extent to which employer-sponsored benefits provide a foundation for retirement savings and the provision of health insurance. This is a legacy of a system providing health and retirement security with its origins in voluntary employer-provided benefits that preceded the introduction of Social Security and government-financed health care. The central role of employer-sponsored benefits presents many advantages for the American economy, including flexibility in labor markets, lower payroll taxes, high benefit levels by leveraging tax preferences, and growth through capital formation and financial market development. Employer plans are also better able to harness behavioral economics to improve outcomes and increase the security of workers.

One simple way to illustrate the importance of employer-provided benefits is to consider what our world might be like without them. If workers were left to choose to buy health insurance on their own, we could expect coverage to be a fraction of what it is today. Without employer-sponsored retirement plans the capacity of individuals to meet their financial needs in retirement, already difficult, would become a significantly greater challenge. This report examines these issues.

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> How would health & retirement security look without employer-sponsored benefits?
Ensuring the security of American workers poses increasing challenges. The share of the population over the age of 65 has gone from 8.0 percent in 1950 to 14.6 percent in 2015 and is projected to increase to 19.8 percent in 2030. On reaching age 65, the number of years an average American can be expected to live has increased by a third since 1900 and is projected to continue to rise to the point where it will be more than 20 years at the end of this century.

At the same time, advances in medical technology and changes in health care practices have led to an explosion in costs. Health-related expenditures now represent nearly one fifth of the overall economy. An average working family can be expected to receive health care that may cost more than $20,000 per year. Treating a major illness can involve costs that may be nearly as great as a typical worker’s lifetime income.

Americans have risen to this challenge in our own distinctive way, creating a uniquely American social insurance system that weaves together privately managed benefits and savings programs in conjunction with public programs that fill gaps and protect the most vulnerable. This unique balance of private and public benefits manages risks through diversification while affording flexibility and efficiency that allow a market economy to flourish. The origins of this system, and remaining at the center linking the elements together, are employer-sponsored benefits.

What sets the United States apart from other prosperous countries is the central role of employer-sponsored benefits. Other advanced industrial countries, beginning with the social insurance system introduced by Chancellor Otto von Bismarck in Germany in 1889, have relied primarily on government programs financed through taxes on earnings. While these provide large economies of scale and risk management through national pooling, this comes at the cost of distortions in labor markets through high taxes as well as opaque and often unintended redistribution. Large public programs are precarious in their financing, poorly accommodate demographic transitions and constrain growth by limiting incentives for saving and the development of financial markets. Reliance on purely individual instruments is also ill-suited to providing security to a modern workforce because they cannot achieve the risk pooling and cost efficiency of group products and may require decisions most individuals are not well equipped or prepared to make.

**EMPLOYER-SPONSORED BENEFITS BRIDGE THE PUBLIC-PRIVATE GAP BY:**

- Bringing together large risk management pools and creating economies of scale.
- Utilizing important behavioral tools including payroll deduction, automatic enrollment and default options.
- Avoiding the “one size fits all” shortcomings of public systems.
- Improving the efficiency of labor markets by allowing employers to attract and retain workers.
- Creating incentives for employers to act as effective agents for their workers.
- Creating real financial assets that enhance security and contribute to economic growth.
- Integrating retirement and health benefits with financial capability and wellness programs.
Employer-Sponsored Benefits Came Well Before Public Programs in the U.S.

In 1875, the American Express Company set up the first formal pension sponsored by a private company in the United States. By the time Social Security was introduced in the 1930s the majority of public employees and more than 15 percent of private sector workers were accruing pension benefits through their employer with coverage reaching 9.8 million workers or about 25 percent of the workforce by 1950.

In 1910, Montgomery Ward established one of the earliest group health plans for its workers and three years later one of the oldest trade unions, the ILGWU, began providing coverage for its members. Employer-sponsored health plans became prevalent during World War II as a market response to the wage and price controls. This allowed employers to better compete for scarce and high value workers, preceding by several decades the introduction of Medicare and Medicaid in the 1960s. Social Security and publicly financed health programs were designed to provide basic poverty alleviation benefits and fill gaps that employers could not address to supplement already existing employer-sponsored benefits.

Current Coverage of Employer-Sponsored Benefits

Today employer-sponsored programs remain the single largest component of retirement savings and health insurance coverage in the United States. The latest estimates published by the Census Bureau in September 2017 indicate that 178 million persons representing 55.7 percent of the population received health insurance through an employer-sponsored plan at some point in the year (see Figure 1).4

Available data indicate that more than two thirds of workers have access to a retirement plan through their employer5 with 69 percent of civilian workers6 having access to a retirement plan and 54 percent of these workers participating in the plan. Among full-time workers the access and coverage rates are significantly higher at 80 percent with access to a plan and 65 percent participating in the plan (see Figure 2).

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2 For a brief overview of the development of employment-based benefits, see “History of Health Insurance Benefits” (Employee Benefit Research Institute, March 2002).
4 Some individuals may have coverage through more than one source and some are over the age of 65.
5 March 2016 National Compensation Survey (NCS)
6 Defined as private sector and state and local government workers – excluding federal employees, military and agricultural workers.
Employer-sponsored benefits provide a number of valuable advantages for the workers and economy of the United States. This long tradition and high level of participation in employer-sponsored benefit programs creates a uniquely effective social insurance system in the United States with an almost equal balance among the primary sources of income in old age. This contrasts sharply with the high reliance on public programs in other countries at a similar income level (see Figure 3).

This results in a significantly lower tax burden in the United States which limits the fixed costs of labor, facilitating competitiveness, economic growth and job creation (see Figure 4).

Limiting the reliance on public programs and the taxes required to finance them allows the United States to maintain a more flexible labor market. This facilitates job creation by limiting the potential burden of payroll and other taxes required to finance public programs. A simple measure of the cost and impact of taxes on labor is the “Tax Wedge”, which estimates the share of income that is paid in taxes for the average individual. This is much lower in the United States than other prosperous countries (see Figure 5).

Employer-sponsored pension and retirement savings funds, that now hold assets of nearly $20 trillion (more than the current GDP of the United States), are the largest single source of investment capital in the world. U.S. funds hold about two thirds of the global pension and retirement savings assets and represent about 10 percent of the world’s financial assets. This long-term perspective and the stability of these funds enhance the development and stability of financial markets.
Employers provide more valuable health benefits to their workers than are typically available through the individual markets. In its recent review of health insurance premiums, the Congressional Budget Office (CBO) referenced a 2010 study that found employer plans covered 83 percent of the costs of health care claims (the actuarial value of the plan) compared to 60 percent for non-group plans purchased. CBO noted that this would amount to an annual out of pocket expense of just $1,765 for a family enrolled in an employer plan compared to $4,127 for a family purchasing health insurance in the non-group market.

Employers are a critical source of innovation in health care benefits that improve outcomes and manages costs. Employer-sponsored plans have been pioneers in value-based purchasing, innovation in health care delivery systems, taking advantage of new technology and tailoring the provision of health care to the needs of individuals. Employers also are able to integrate workplace-based wellness programs and provide incentives for participation that improve the welfare of their employees and help contain the costs of health benefits. A 2012 report by the Rand Corporation reviewed a number of studies evaluating the return on employer wellness programs. The return on investment ranged from $1.65 to $6.00 for each dollar spent.

Employer-sponsored plans are now making as great, if not a greater, overall contribution to incomes of older Americans than Social Security benefits. A recent study by Census Bureau researchers matched income tax filings, employer plan reports, Social Security records and other sources of data to obtain a more complete picture of income received by older Americans than previously available. This found that 68 percent of households over the age of 65 were receiving some type of retirement income from a source other than Social Security, with the proportion of lower income households with this supplemental retirement income as much as five times the share reported on household surveys. This study found that among those who were receiving some pension or IRA income (many of whom are also continuing to work), the amounts were substantial in 2012, with an average income of $27,550 across households of all income levels (see Table 1).

Another research project carried out using administrative data gathered by the Internal Revenue Service looked at what happened to individual income levels around the time that Social Security retirement benefits were claimed. This found that when using the tax records of earnings, while higher income groups had substantially higher incomes in retirement, the replacement rates for lower income groups were above 100 percent and higher than for those with greater levels of pre-retirement earnings.

<table>
<thead>
<tr>
<th>Income decile</th>
<th>% receipt</th>
<th>Average amount for those reporting pension income</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>36%</td>
<td>$17,202</td>
</tr>
<tr>
<td>2</td>
<td>41%</td>
<td>11,810</td>
</tr>
<tr>
<td>3</td>
<td>57%</td>
<td>15,249</td>
</tr>
<tr>
<td>4</td>
<td>66%</td>
<td>20,610</td>
</tr>
<tr>
<td>5</td>
<td>76%</td>
<td>21,410</td>
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<tr>
<td>6</td>
<td>81%</td>
<td>24,631</td>
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<tr>
<td>7</td>
<td>84%</td>
<td>25,569</td>
</tr>
<tr>
<td>8</td>
<td>81%</td>
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</tr>
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<td>9</td>
<td>80%</td>
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</tr>
<tr>
<td>10</td>
<td>78%</td>
<td>54,528</td>
</tr>
<tr>
<td>all</td>
<td>68%</td>
<td>27,550</td>
</tr>
</tbody>
</table>
Tax favored employer retirement plans provide an efficient way to complement the redistribution of Social Security benefits. The current value of the tax expenditure for all forms of retirement savings is estimated by the Office of Management and Budget (OMB) to have been $138 billion in 2012. Comparing this with the more complete estimate of income receipt discussed above indicates that, in contrast to Social Security, the value of employer-sponsored benefits is several times the fiscal costs for the year on either a cash flow or present value basis.\textsuperscript{10} In 2012, for every $1.00 of tax expenditure, $7.15 was paid by retirement plans (see Table 2).

\begin{table}[h]
\centering
\begin{tabular}{|c|c|}
\hline
Total tax expenditures & $138 \\
\hline
Pension and IRA benefits paid to: & \\
Persons ages 18 to 64 & $396 \\
Persons aged 65 or over & 995 \\
\textbf{Total paid} & 991 \\
\hline
Ratio of benefits paid to total estimated tax expenditure for: & \\
Persons aged 65 and over & 4.29 \\
All persons regardless of age & 7.15 \\
\hline
\end{tabular}
\caption{Tax Expenditures for Retirement Plans in 2012 Compared to Benefits Paid by the Plans (Billions of Dollars)}
\end{table}

\textdollar{671.9} Billion Employer Payments for Group Health Insurance \div \textdollar{145.5} Billion Tax Expenditure\textsuperscript{12} = For every \$1 of tax expenditures, employers paid \$4.61 to finance health benefits.

The tax expenditure for health insurance provides a similar high ratio of benefits in relation to the value of the exclusion of employer payments for group health insurance. This can be estimated by looking at the total value of employer premiums paid for group health insurance reported in the national income and product accounts (NIPAs) and comparing it to the value of the tax expenditure calculated by U.S. Congress’ Joint Committee on Taxation (JCT). In 2015, the ratio was 4.61 of benefits provided by employers for every $1.00 of tax expenditures.

Employers are able to use new behavior-oriented benefit designs to achieve higher levels of retirement plan participation and savings than are available in other voluntary systems. Only a small proportion of people who can contribute to an IRA are making a contribution each year. By contrast, payroll deduction plans in the workplace are often able to reach participation rates as high as 80-90 percent of workers. Automatic enrollment features have been shown to nearly double the rate of participation and default choice architecture increases the level and efficacy of retirement savings programs by placing workers into investment vehicles that are consistent with their needs as they evolve throughout their life cycle.

Section 2


IT’S A WONDERFUL LIFE: HOW WOULD HEALTH AND RETIREMENT LOOK WITHOUT EMPLOYER-SPONSORED BENEFITS?

The Employee Benefit Research Institute (EBRI) worked with the American Benefits Council to develop a model simulating how many, and the characteristics of, workers now obtaining health benefits through an employer who could be expected to purchase insurance in the individual market in the absence of employer-sponsored benefits. This provides a simple illustration of the contribution employers make to coverage. The 2013 data was used because it is the most recent year that there was no individual mandate to purchase coverage and no corresponding premium subsidies. These factors make 2013 the most recent year in which the likelihood of an individual purchasing insurance solely on their own can be estimated.

In 2013, 108.7 million workers ages 18-64 received coverage through an employer. Applying the patterns derived from analysis of workers without an employer offering health benefits to their employees, the model estimates that only 31 percent of these workers would purchase coverage on their own. Translating this percentage change to the total employer-sponsored coverage of 164.7 million in 2016 (which includes workers and their family members covered under the employer plan) would indicate that more than 113 million individuals would not be likely to purchase coverage in an individual market if their employer did not offer benefits. Perhaps even more important than the overall coverage rate is that employer sponsorship extends coverage to groups who might otherwise not be able to afford or choose to purchase health insurance (see Figure 7).

When it comes to health status, employers are particularly important in bringing younger and healthier workers into the risk pools and extending coverage to those with poor health status who need coverage but often find it unaffordable in an individual market. Perhaps the most concerning finding is that younger workers are generally less likely than older workers to purchase health insurance in the absence of employment-based coverage (see Figure 8).

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In the classic holiday movie It’s a Wonderful Life, the lead character, George Bailey (played by Jimmy Stewart), in the depths of despair over the impending failure of the family business, contemplates ending his life on Christmas Eve by leaping from a bridge into the frigid waters below. Just as he is about to jump, his guardian angel, Clarence, accosts him at the railing and convinces him to embark on an imaginary journey that will allow him to understand just how important and meaningful his life has been, by seeing what the world might have been had he never been born.
FIGURE 8. SIMULATED CHANGE IN COVERAGE BY AGE GROUP

Employer-sponsored benefits can be similarly seen to have a major impact in improving the retirement security of American workers. In the late 1990s EBRI developed a model to simulate retirement income adequacy. This model can be used to analyze how individuals can be expected to change their behavior and retirement savings in response to the options available to them. The model provides summary Retirement Readiness Ratings (RRR)\textsuperscript{13} that simulate the proportion of households projected to have adequate resources in retirement.\textsuperscript{14}

The importance of employer-sponsored retirement benefits can be seen by comparing the figures for each income quartile in Figure 9 that show the Retirement Readiness Ratings for all US households currently with a member age 35-64.\textsuperscript{15} This shows the estimated differences in retirement readiness with and without employer-sponsored retirement plans. Comparing the 29.8 percent of the lowest income households simulated to have adequate retirement resources if no employer-sponsored retirement plans were available, with the 38.4 percent of those who would have adequate retirement income under the baseline scenario, indicates that employer-sponsored plans result in a 28.7 percent increase in the number of low income households achieving retirement security as would be the case in the absence of employer sponsorhip of retirement plans.

While the importance of employer-sponsored retirement benefits to low-income households will not come as a surprise to anyone who has studied this issue, what is most illuminating is the extent to which middle and higher income groups rely on retirement savings plans through their employer. Comparing the Retirement Readiness Ratings with and without employer-sponsored retirement benefits shows that the percent increase in the number of households that are saved from retirement income inadequacy is 52.3 percent for the second income quartile and 18.6 percent for the third income quartile. The number of highest income quartile households that are saved from retirement income inadequacy as a result of employer-sponsored retirement plans is only 6.8 percent. But, this is due to the fact that 92.4 percent of them would already have adequate resources for retirement (assuming no long-term care expenses) with employer-sponsored retirement plans. If the potential cost of long-term care is incorporated into these projections the overall level of the readiness ratings becomes lower.

Equally telling is the total dollar value of the benefits that are projected to be provided by employer plans and their role in covering the difference between public benefits and the financial needs of retirees. This is illustrated by EBRI’s projections of Retirement Savings Shortfalls which calculates the aggregate value of projected financial deficits in retirement for all US households between the ages of 35 and 64 (see Figure 10).\textsuperscript{16} This measurement is somewhat different than the Retirement Readiness Ratings because it also includes the anticipated needs to finance long-term care. The savings shortfall measures the present value of the additional (after-tax) amount each household would need at age 65 to eliminate their expected retirement income deficits. This shortfall is a relatively small proportion of the total value of all of the resources households are projected to have available to meet their retirement needs. However, it provides a useful indication of the overall value of the gap that will need to be
addressed and the role of employer-sponsored benefits in filling this gap. The aggregate deficit number with current employer-sponsored retirement benefits is estimated to be $4.13 trillion. If the simulation were done assuming that there were no employer-sponsored retirement benefits and individuals were to behave in the manner observed for those without access to these plans, the aggregate deficit would jump to $7.05 trillion, an increase of 71 percent.

**Conclusion**

These simulations illustrate just how important employer-sponsored health and retirement benefits remain to the future financial security of American workers. Without this central element of uniquely American social insurance, tens of millions of workers who now receive valuable health benefits through their employer would be forced into the individual market. Americans would also significantly increase the risk that they will run short of the necessary resources to ensure their security in retirement. In the same way that in *It’s a Wonderful Life* George Bailey comes to understand just how important his life has been to so many others, the unique role and value that employer-sponsored benefits contribute to making the lives of American workers “wonderful” is perhaps best understood by considering how our world might look without them.

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13 The RRR is defined as the percentage of simulated life-paths that do not run short of money in retirement. A household is considered to run short of money in this model if aggregate resources in retirement are not sufficient to meet average retirement expenditures, defined as a combination of deterministic expenses from the Consumer Expenditure Survey (as a function of age and income) and some health insurance and out-of-pocket, health-related expenses. The model can be run either including or excluding long-term care costs in retirement. For purposes of this analysis, these costs were not included.


15 The baseline scenario assumes that there will be no change in plan type or the relative probability of eligibility or participation in the future. For additional simulation results when these assumptions are relaxed, please see www.bit.ly/ebri-RSPM

OVERVIEW

The United States has an exceptional benefits system in which employers play the primary role in securing health and financial well-being for Americans.

- More than 178 million Americans — 55.7 of the population — receive employer-sponsored health care coverage.
- More than two thirds of workers get access to a retirement plan through employer-sponsored programs.

The almost equal reliance on public programs and employer-sponsored programs as a source of income in old age significantly lowers the tax burden in the United States, facilitating competitiveness, economic growth and job creation.

- In 2015, for every $1.00 of tax expenditure, $4.61 was paid by employers to finance health benefits for workers, retirees and families.
- In 2012, for every $1.00 of tax expenditure, $7.15 was paid to retirees by employer-sponsored retirement plans.

Simulations based on behavior of individuals in the absence of an employer-sponsored benefits system indicate that...

- 113 million workers who now receive valuable health benefits through their employer would otherwise not be able to afford or would choose not to purchase health insurance.
- The aggregate retirement savings shortfall in America would jump to $7.05 trillion, an increase of 71 percent from the current system.