WHO PAYS FOR CONTRACEPTIVES UNDER THE AFFORDABLE CARE ACT?

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ABSTRACT

The Affordable Care Act (ACA) mandates that employers provide their workforce with health insurance or pay a fee. To reduce unwanted pregnancies and communicable disease, the Act stipulates that this health insurance cover contraceptive drugs and devices without a co-payment by the employee. This provision is objected to by several employers in religious-affiliated institutions on the grounds that it violates their moral teachings.

The proper use of the demand curve permits the Principles of Economics instructor to show that in the standard employer/employee exchange of the value of work for compensation, each side in the exchange pays for what the other side is offering. In the case of the ACA mandate, it is the employee, not the employer, who pays for the contraceptives. This holds true both when the employer contracts with a health insurance company; when the employer self-insures; and even when the employer does not offer insurance as part of the employee compensation but instead pays the fee required under the ACA.

INTRODUCTION

Since World War II, it has been common for employers to include health insurance benefits as part of an employee's compensation package. With a wage freeze in effect during the war, employers relied on "perks" to attract workers to their firms. The wage freeze was eventually lifted, but the practice of employer-provided health benefits continues to this day. The recently approved Affordable Care Act (ACA) mandates that employers provide employee health insurance. Those employers who choose not to do so must pay a fee per employee so that their employees can purchase health benefits through an insurance exchange.

The ACA stipulates that the benefits include coverage for all FDA-approved drugs and devices for contraception and sterilization, including intrauterine devices (HHS Factsheet) and the "morning after pill." Entities with direct religious missions, such as churches and novitiates were exempted, but not religiously affiliated entities such as universities. This stipulation elicited strong objection from Roman Catholic bishops who asserted a conscientious objection to being forced to purchase something they consider to be morally offensive. They argue for an exemption from these regulations and for the right to define who is a religious employer entitled to the exemption.

This confrontation presents a "teachable moment" for the economics instructor. Students can be shown the power of economic reasoning in resolving issues that are seemingly unrelated to economics. Since the future of healthcare in the U.S. may be dependent on the outcome of these disagreements, the economics instructor should not miss this opportunity to teach students how to think about such an economic issue. Students should know that it is often the case that a public policy argument is won or lost using the simplest tools of analysis (knowing which tool to use and when is essential). In this article, a simple demand curve is employed. The key relationship between the religious employer and the employee is the exchange of the value of work for the value of the compensation. Once this is put into a simple yet powerful economic diagram, students can better evaluate the arguments.

To respond to the bishops and get on with implementing coverage for some 49 million uninsured citizens, the Obama administration introduced an amendment omitting this controversial coverage for hospitals and religiously affiliated anti-poverty operations, universities, schools, and outreach programs. However, their amendment (Statement by HHS Secretary Sibelius) also included a provision enabling an employee of a religious-affiliated organization to apply directly to an insurer for a no-cost rider that would provide this coverage. The Church viewed this as a ruse - a simple rider on an employee health benefit that the Church buys for the employee. This led Notre Dame University and a number of other Catholic universities to file a lawsuit (Notre Dame v. Kathleen Sibelius) requesting that the mandate be rescinded.

THE LAW OF DEMAND DEFINES EMPLOYER/EMPLOYEE RELATIONSHIP

A job is an exchange of work for compensation. This exchange is mutually beneficial: the employer will never knowingly pay more than the value of the work received; the employee will not accept less than the value of the best available alternative employment. Whether the compensation is cash only or a package of cash and benefits, the employee earned the compensation by work.

The standard theory of labor demand found in Principles of Economics texts (Mankiw; Krugman/Wells; and Samuelson/Nordhaus) as well in those focusing on labor economics (Ehrenberg and Smith) describe the demand for labor as a "derived demand." That is, the demand for labor stems from its role in helping to generate profits. The contribution an employee makes to profit (the employee's marginal revenue product) is the value of the work performed.

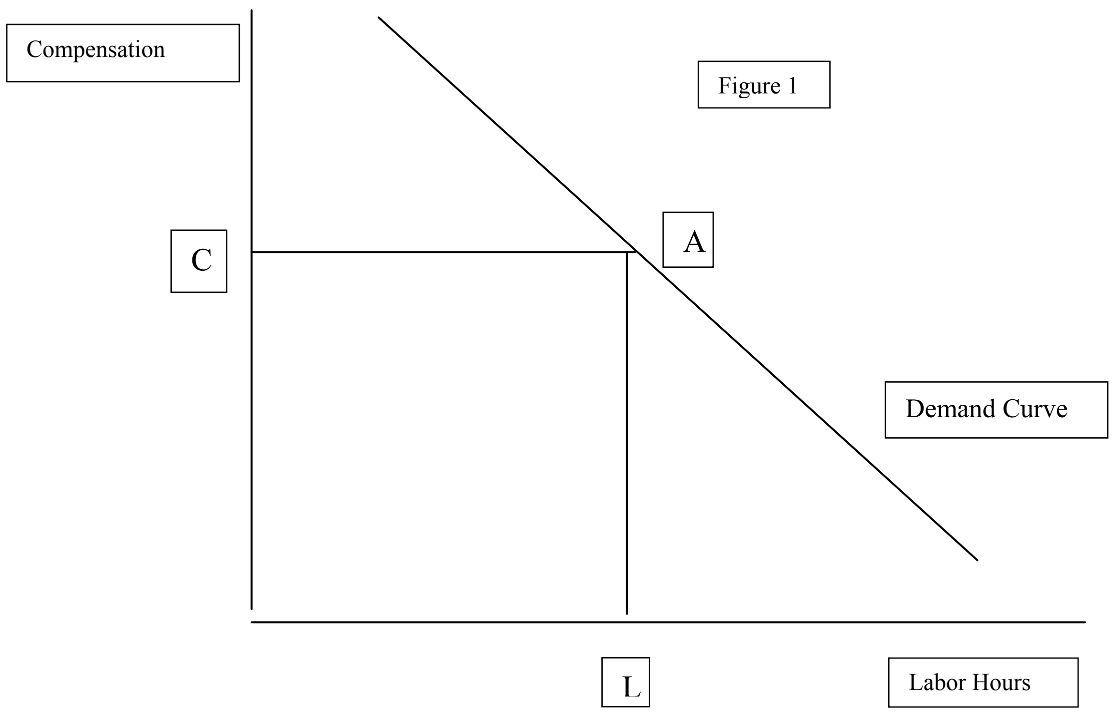
As with any exchange, each side "pays for" what the other side is offering. In the job setting, the employee is paying for the compensation by performing the work, just as the employer is paying for the work by providing the compensation. To be clear: the employee is paying for the entire compensation package (including the health benefits) in this employee/employer exchange. Employees buy the insurance with their work just as surely as they buy their wages with their work.

No one forces employees to spend their wages on the offending contraceptives, nor does anyone force the employee to opt for contraceptive drugs or devices even when they are covered under insurance provisions. If the employee does not want to use contraception, the ACA does not force them to change that decision. If the bishops are worried that Church-affiliated hospitals, universities and other employers are "buying" offending products and services when they "buy" health insurance that covers their employees, they can rest easier: the employee buys that non-wage compensation, not the employer, and the employee opts to choose the contraceptives, not the employer.

Figure 1, a conventional demand curve, illustrates the argument. The instructor can demonstrate that the demand for labor is shown with total compensation (not just money wages) on the vertical axis[1] Total compensation is the sum of current compensation (wages and health insurance) plus deferred compensation (pensions and other accumulated assets). This treatment is appropriate since the health insurance in question is a form of current compensation that is clearly separate from wages. As in the conventional analysis of free exchange [2] between buyer and seller, the height of each point on the demand curve shows the employer's maximum willingness to pay the total of wages and non-wage compensation for a unit of employee services. The employer would be unwilling to pay more, but of course would be willing to pay less. The horizontal axis shows labor hired, L, measured in hours while the vertical axis shows compensation per hour worked.

When hiring an employee, the firm must pay total compensation worth at least the employee's opportunity cost. The C line shows that opportunity cost at C dollars per hour worked. The intersection of the C line and the demand curve at point A shows how the firm decides how many worker hours to hire. The firm is just willing to hire worker-hour L when the compensation is C. To the left of point A, the employer derives a surplus, paying the worker less than the firm would be willing to pay. Points to the right represent worker-hours that the firm is unwilling to buy. The key is that the summation of the compensations must equal C, not the individual components of that compensation. Therefore, if the government mandated benefit adds a dollar per hour to compensation while the maximum willingness to pay remains at point A, then other compensations would have to fall by one dollar to leave the total the same as before.

What the employee does with the money earned is separate from and subsequent to the exchange of work for pay. The same holds for the way the health insurance benefit is spent. Suppose the employee decides to spend some of the wages on dinner at a restaurant. It is clear that the employee and not the employer bought the dinner. The same conclusion follows when compensation includes fringe benefits. The benefits are neither a gift nor some form of excessive compensation. They are part of the employee's earnings, just as are wages. Having contracted to exchange work for a compensation package that includes health insurance, employees are entitled to spend their earnings as they see fit, including choice among the options within their insurance coverage.



The decision to buy contraceptives financed by their health insurance is separate from and subsequent to the exchange of work for compensation. The decision to use their benefits for birth control is a matter of the employee's choice. The bishops may preach that as a matter of faith they should not engage in the religiously prohibited act, but the contraceptive coverage requirement in the ACA, with or without President Obama's "accommodation", does not change the basic economics: the employee, not the employer, pays for the insurance through the exchange of work for compensation.

THE SPECIAL CASES OF SELF-INSURANCE AND REFUSAL TO PROVIDE INSURANCE

This conclusion does not change if the employer is large enough to self-insure. For example, if the employer is a well-endowed university with a large number of employees, it may calculate that it is cheaper to simply spread the risk of health costs across its employees than to contract out that risk to an insurance company. The decision to self-insure versus contracting with an insurer is not part of the stated mission of the religious employer; it is simply one of the many business choices any employer makes. Even when the firm decides to self-insure, the employee still pays for the health insurance through the exchange of work for compensation.

As the demand curve further shows, this result does not change when religious employers opt not to provide insurance. In such instances, the ACA requires those employers to pay a fee to the government. The mandate then reverts to the employee who will make an independent insurance purchase in the ACA exchanges. Who pays the employer's fee in this case? Once again, the answer is counterintuitive: the employee pays the fee through the difference between the value of the work performed minus the value of compensation. As before, the worker will be paid a rate of compensation that is at least as great as the worker's opportunity cost. As the demand curve shows, the employer will offer no more in total payments, including the fee, than the value of the work performed, *i.e.*, the summation of the fee plus wages plus other compensations equals the marginal value of the work shown at point A. In this way the value of the work covers both the wages to the employee and the fee to the government, and consequently, once again the employee pays for the health insurance, not the employer[3].

CONCLUSION

Simple demand analysis shows that employers have an upper bound on their willingness to pay compensation for worker services. Workers must be able to earn that compensation with the value of the work they perform. Consequently, they earn both the wages they are paid and the non-wage compensation they receive. The sum of wages and non-wage compensations must meet the market compensation level. When this includes health care benefits, the worker pays for it in the exchange of work for compensation. Just as the worker can freely spend earned wages on things the employer might disapprove of, the worker can spend the privileges provided under health insurance in ways the employer does not approve of. And, for the same reason: the worker paid for it.

ENDNOTES

[1] The demand curve is downwards sloping in both the cases of a competitive labor market, and the case in which the employer has some monopsony power. In the former, the demand is derived as the "value of the marginal product of labor," or VMP. In the latter, the demand is derived as the "marginal revenue product," or MRP. The argument here works in both cases and so the single figure is used, and point A shows what a unit of work is worth to the employer.

[2] Even though the obligation under the ACA is not a "free exchange," but rather a "mandate," the buyer-seller relationship in the labor market is a free exchange.

[3]. A reviewer suggested that this analysis might be confused with tax incidence analysis in which the incidence of a tax is shared by buyer and seller according to elasticities of demand and of supply. There the key is a comparison of pre-tax and post-tax payments and receipts to determine the legal and economic incidence of a tax. These are not the same problem, but there is a crucial similarity. In both the tax-incidence analysis, as well as here, the value of the good or service bought must be at least as great as the total payments made by the buyer, including taxes, or else the buyer would not buy. Here the buyer is the employer, and what the employer is buying is labor services, so the value of those services must be at least as great as total payments made by the employer.

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