Personal Finance Course

Why Do We Have Employer Based Health Insurance?

Guest Lecture by
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OK. Hi everyone. I am here today to talk about employer-based coverage. And the first question I want to answer is, why in the United States do we have employer-based based coverage? And I'd like to suggest that it's because of an accident of history, or maybe two or three accidents of history.

The first accident of history is that we had a depression. That wasn't a very fortunate time in our historical period. But at that time, hospitals were not able to stay alive. They weren't viable. People couldn't afford to go to the hospital. And therefore, they were sick. They died at home. And hospitals tried to figure out a way that they could stay alive. And what they decided was they would ask people to pay a little bit every month. And in the event they got sick, they would have, if you will, prepaid. And so this was a way of hospitals getting a cash flow. And people to invest, if you will, in a future illness. This was called Blue Cross. Doctors saw this and saw that hospitals were able to stay viable. And decided to follow suit. And they started Blue Shield, in which people paid their doctors a few cents, $1 if you will, every month. And in the future they would have coverage. So that was the first accident.

So the second accident is that World War II happened. And because of this, men were overseas. And there were very few working able-bodied persons, men and women, who could work in the US. And so prices, salaries kept rising. So what the federal government did is they decided to put a freeze on salaries. Well, what this meant is that companies couldn't pay someone more to work for them. But they thought of other ideas. They thought, what if we give you food? What if we give you daycare? What if we pay your Blue Cross or your Blue Shield items? This was a way of enticing employees to work for that employer without the employer paying higher salaries. So these are called fringe benefits.

The third accident is the federal government decided that these fringe benefits would be not only outside the cap, but would be outside of the tax basis. So they would be tax free. So the end result of these multiple accidents is that employers could not pay people more. But they could give them these free fringe benefits. So they were fine. And employees, who would like to have been paid more, instead were getting their extra benefits paid for. And in particular relevant to this talk, they would get their Blue Cross payments to the hospital paid for. And their Blue Shield payments to the doctors pay for. So employers didn't mind if they paid $100 to an employee, and then paid $50 more for benefits. It's a total of $150. They paid $150. That's what they had a bargain for.

Employees, on the other hand, were really happy with this. They would get $100 of salary, and $50 dollars worth of benefits they did not have to pay tax on it. If they had gotten $150 in salary, for example, and then turned around and paid for $50 in benefits, they would've gotten fewer benefits, because they were able to get these benefits with tax free dollars. So the end result is that health care is now a fringe benefit in the American marketplace. Over 51% percent of Americans get their coverage through their employer. This coverage is subsidized by the federal government because they don't charge taxes. And this subsidy that the federal government is giving to the Americans who are working and getting coverage through their employer is over $250 billion per year. So it's a loss of taxes.

Now, employers have evolved beyond the Blue Cross and Blue Shield of the Depression era and World War II era, and have tried different mechanisms for getting health care to their employees. Employees who, by the way, now expect to get coverage through their employer. Well, there are different kinds. And it's evolved over the years. It started with an indemnity plan, which was just the employee would go to the doctor, and the doctor would bill the employer. Well, there was another idea out there that actually started at the same time these indemnity health care plans started. And these are what we call service plans. These started in the 1930s. Well, they too started from a story similar to employer based coverage, something that came out of the Depression. These service plans have changed names. And now we call them HMOs, Managed Care Plans. But I'm going to tell you the story of one service plan, Kaiser, because it explains why we have these plans. And ultimately, why employers chose these plans.

So Henry Jay Kaiser owned a steel company. And he built ships for war. He built aqueducts. He was a major construction person. And one of his tasks in the 1930s was to build an aqueduct bringing water down to LA. And so he would hire employees, work men that built the aqueduct. And if these employees got hurt, they would have to go to LA or San Francisco and leave the site. And this was a huge cost to Kaiser. And it meant the employee or employees would lose their job. Because when they left, someone else would get hired. So a young doctor named Sidney Garfield, in the Depression era, couldn't find a job. He set up a clinic near a Kaiser work site. And he started treating the employees. Well, the employees were pretty healthy men that didn't get sick very often. And so Garfield really wasn't making a living. And he decided after a while that he was going to have to leave and not be able to stay put at the site. Well, Kaiser wanted him to stay. Because even though not that many people got hurt, when they did get hurt, it was a real saving grace for everyone. The person could be fixed up right away and go back to work. So Kaiser said to Garfield, look. Stay here. I'll give you $1.50 per worker per month. And you stay here, and I'll pay you whether or not they come to you. But I need you to stay. And the employees could also give another $1.50 to Dr. Garfield, to cover expenses that happened outside the work site, for example brawls at the bar and so forth. So Garfield was either getting $1.50 per person, or maybe $3 if they opted to for him to stay there. And he was making a living. And he was happy, and it worked out. Well, Kaiser got new work sites. And so Garfield hired doctors and put them at the new work sites. And they grew and grew together. So much so that when Kaiser opened his big shipyard in Richmond, California, Kaiser built a big hospital in Oakland, California.

Well, Kaiser's situation was set up where the workers knew how much it was going to cost. And employers looked at this and said, wow. I know how much it's going to cost. I like that idea. Whereas in the old indemnity plan, if someone got sick, prices went up. If doctor's charged more, prices went up. So employers saw the situation through these service plans and said, that's the model I want. So we still have fringe benefit employer-based coverage, but employers are starting to branch out and look at different options. And they decided to move more and more and more to these service plans, AKA health plans, AKA managed care plans, AKA HMOs, which we'll talk about more later.