Lecture 1: Mandate Incidence

(ref: Summers, "Some Simple Economics of Mandated Benefits," AER 1989)

Clear cases of direct government provision: Public education, old-age benefits, health benefits in some but not all industrialized countries

Clear mandate examples: Employers must provide safe, accessible workplaces and Workman's Compensation Insurance

Middle ground: Unemployment insurance (UI) for workers is provided directly by most European governments, but supported by a benefit tax on employers in the U.S.

Economists have generally regarded mandates as disguised taxes and expenditures:

"[Just because] the fiscal flows triggered by mandate would not flow directly through the public budgets does not detract from the measure's status of a *bona fide* tax." (Reinhardt (1987)

Summers argues that mandates have different efficiency and distributional consequences than public expenditures funded by general taxes, and similar consequences to public programs funded by benefit taxes.

In the standard competitive equilibrium, economic theory says no mandates. Employers compensate their employees through cash, benefits, gifts of cons'n goods. If (eg) the cost for the employer of providing a health benefit is less than its value to the employee, then the employer will provide health insurance and the wage will be reduced by some amount between the employer's cost of providing it and the employee's benefit from having it.

When is there reason for intervention? Answers similar to those for the more general question of when there exists cause for government intervention:

(1) **Externalities** In our health insurance eg, there may be positive externalities relating to public health in the work environment, like the public benefit from having a contagious co-worker treated for strep.

There is certainly a positive externality to health insurance resulting from the fact that our society will not deny care in emergencies to the uninsured. This externality is large: ~60% of the benefit to employer-provided health insurance accrues to neither employer nor employee and is accounted for by this cost of the uninsured.

(2) **Adverse Selection** Employees have more information about their expected medical costs than employers.

Numerical example: Sps .9 of workers are in good health, the cost of insuring them is $90ea, and they value insurance at $100ea. The other .1 of workers are in poor health, cost $270 to insure and value insurance at $300. An employer who offers health insurance to workers at a wage-cost of less than $100 will attract both types, and will lose money because the average cost of insuring will be $108. If they raised the wage-cost of the offered insurance they would attract only the sick. Firms might therefore decide not to offer insurance, and sick workers willing to pay $30 more than what it costs to insure them will go uninsured.

Arguments in favor of mandated benefits:

Even if mandated benefits are simply taxes, mandated benefits allow employers to provide benefits. Employers may be better able than the government to **tailor benefit packages** to their workers' needs.

Mandated benefits lead to (weakly) **less deadweight loss than tax collection**. If the government mandates a leave policy that costs employers $.10 per worker hour, then those firms that already provided the benefit because their employees values it at >= $.10 would be uninfluenced. For those firms whose employees value it less than $.10, the demand for workers would shift down by $.10, the supply of labor would shift down by the amount that the workers do value the plan and in equilibrium the new employment would be higher than had the government simply instituted a $.10 wage tax.

Consider the extreme cases: If all workers value the policy at very near $.10, employment, employer cost and employee utility are nearly unaffected by the mandate. If all workers value the benefit at 0, then the mandate has the same influence as a $.10 tax. In general mandated benefits impact the effective marginal wage by the difference between employer cost and employee benefit from the policy, while a general tax financing the policy (which is then supplied by the government) changes the marginal wage by the full amount of the tax.

[to chalkboard for simple S-D analysis]

If the link between the tax for the policy and the benefit provided for it were direct (as in the case of **benefit taxes**) then the efficiency consequences would be the same as for the mandate.

Problems with mandated benefits:

They **only help those with jobs**. (Consider the problem of the uninsured.)

Wage rigidities. Examples:

(1) Minimum wage: If the minimum wage is binding, wages cannot fall to offset the cost of mandated health insurance, and unemployment will result. Note that a general payroll tax on employers to finance a public health insurance program would have the same problem.

(2) Payment of the same wage to different types of workers, despite different costs of (eg) health insurance to meet the mandate. Older workers are harder to insure, so this would cause employers to shift their hiring toward younger workers, and thus have efficiency consequences. Publicly provided benefits don't lead to different costs of employment for different workers and therefore don't create this distortion.

Mandates are non-redistributive Social Security Old Age benefits couldn't be financed through a mandate and still be as redistributive as they are, because under perfect labor-market competition the wage for each employee after the program falls by the value of the benefit to the worker. In order to give one worker a larger benefit than others', her wage must fall by more.

They don't appear in the budget, so policy makers might be less than frugal with them.