Questioning Jonathan Gruber's "Wage Growth" Promises

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When "ObamaCare" (the Patient Protection and Affordable Care Act—PPACA or ACA) was being sold to the country in 2009-2010, few Americans with employer-sponsored health insurance thought it would affect them. Workers were repeatedly assured by President Obama[1,2] and lawmakers:[3] "If you like your plan, you can keep your plan."

During the law's rollout, health policy journalists[4-6] also insisted that job-based health plans would be protected. Ryan Lizza, interviewing economist Jonathan Gruber of Massachusetts Institute of Technology (MIT), concluded that "about eighty percent of Americans are more or less left alone by the health-care act—largely people who have health insurance through their employers"[4] (see Figure 1).

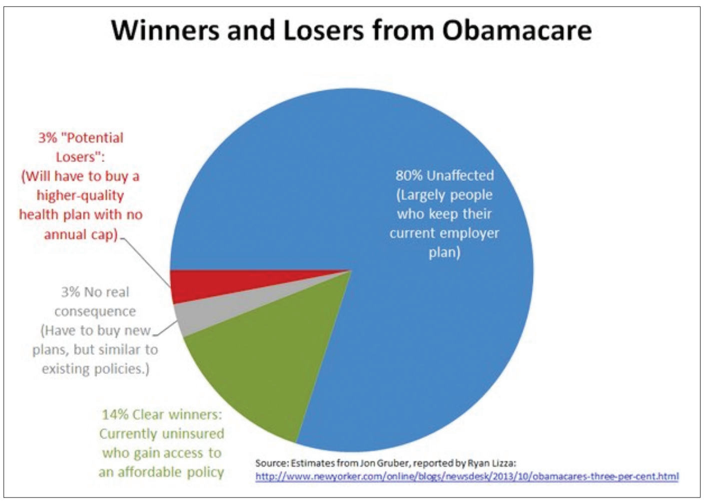

Figure 1. Winners and Losers from ObamaCare. Chart drawn by Justin Wolfers from figures supplied by Jonathan Gruber.[4] Reprinted with permission.

These claims were plainly false. American workers are being increasingly burdened by leaner coverage—and higher deductibles and co-insurance—as businesses begin reducing exposure to ACA's so-called Cadillac tax.[7]

This financial hardship was planned by the law's creators. To understand this, and how the Cadillac tax was instead marketed as a boon to workers, a dive into the tax's history is necessary.

A 40% excise tax on insurance plans valued above a dollar threshold, the Cadillac tax, imposed in 2018 and beyond, is first assessed against insurers, then passed along, through higher premium costs, to employers. Because the threshold is indexed to ordinary inflation rather than the higher rate of increase in healthcare costs, the tax will eventually target even the skimpiest policies insurers offer.[8]

Gruber, the "ObamaCare" architect captured on video repeatedly boasting about deliberately misleading the public,[9] had reassured workers about their coverage[10,11] even as recently as last April.[12] However, he'd previously confided to a 2011 Boston audience that the law's designers intentionally pitched the Cadillac tax as "a tax on insurance plans rather than a tax on people, when we all know it's a tax on people who hold those insurance plans."[13]

The "Affordable Care Act" masterminds envisioned a twofold virtue to the tax. First, increased patient cost-sharing would lower national health spending by discouraging workers from consuming medical care. Law professor Edward Zelinsky wrote that the tax "would be passed on to the employer and that the employer, in turn, would transfer this additional cost to its employees. In this indirect fashion, the Cadillac tax should sensitize employees to the high costs of their health care coverage."[14]

Steve Wojcik of the National Business Group on Health explained that "if employees have more cost sharing…then they're more mindful when they access health care to choose a more efficient provider, or say, 'You know, I don't need to go to the doctor every time I have a cough.'"[15]

The Cadillac tax was also designed as a major financing mechanism. In its scoring of the 2009 Senate bill, the Congressional Budget Office (CBO) projected that the tax would reap $201 billion from 2013 to 2109, and that "receipts would grow by roughly 10 percent to 15 percent per year in the following decade."[16]

Very little of this revenue was expected to result from direct taxation of insurance plans; companies were expected to devalue—or drop—coverage to avoid it. Instead, most receipts were thought to accrue from payroll and income taxation of worker pay raises.

Sen. Max Baucus, then-chairman of the Senate Finance Committee, explained the tax on the Senate floor. "The bulk of the revenue raised by this provision, more than 83% of it, comes not from the tax itself, but from increased wages—increased wages—as [*sic*] account of this provision. And MIT economist Jonathan Gruber estimates this provision will cause worker wages to rise by $55 [per month] in 2019. That is $700 in additional income for every household with health insurance."[17]

It was fitting that Baucus cited Gruber's calculations in describing "wage growth." Gruber worked intimately with the administration and helped craft the Cadillac tax in July 2009, when the White House was gravely concerned about obtaining CBO's "deficit-friendly" blessing.[18]

Gruber's promise was that as the tax forced a reduction in the generosity of company plans, employers would offset the losses through pay hikes. But is this promise reasonable? The Clinton Administration thought so, also betting on Gruber's "wage growth" for financing its 1993-1994 reform package.

Taxing Pay Raises

Under the Clinton bill, companies were projected to "shift to wages" any savings or costs resulting from the mandate to provide insurance. Employers newly offering health insurance were predicted to offset costs by reducing wages; businesses that had previously offered coverage would receive government subsidies and were expected to distribute savings to employees through wage increases, which of course are taxable.

Gruber explained the process to a healthcare reform group in December 1993 and again to a House committee.[19,20] When testifying before a Senate committee in July 1994, he again maintained the assumption's legitimacy.[21]

Gruber's research apparently convinced the 1994 CBO of a direct relationship between wages and health insurance expense. CBO published the following assumptions:[22] "Employers facing an increase in their premiums would probably shift most of the added cost to their workers by reducing cash wages" and "employees of firms that would pay less would receive higher wages." In support of these premises, CBO cited only two research papers (one that was still in press), both authored by Jonathan Gruber.

CBO wrote:[22]

> [B]usinesses have little trouble shifting most of the cost of health insurance to workers' real wages. Similarly, workers gain the lion's share of any reductions in employers' health costs. Two recent studies of mandated benefits mirror this view [see references 23 and 24]. In one study, firms shifted 85 percent of the cost of mandated "workers' compensation" accident insurance to workers in the form of lower real wages; another study found that virtually all of the cost of federal and state mandates for childbirth coverage was passed into lower real wages.

Gruber's two studies suggested that increased company costs are at least partially offset by wage reductions; neither explored whether premium reductions result in pay raises.[23,24] Nonetheless, three Administration economists offered Gruber and Krueger (1991) as their exclusive "empirical evidence" of wage growth in their contemporaneous *Health Affairs* article.

> Costs increase for firms that are not now offering insurance, by an average of $1,292 per worker. Costs fall for firms that are now offering insurance, however, by $610. Most of these cost savings are likely to be passed on to workers in the form of higher wages or other fringe benefits. Empirical evidence suggests that 80–100 percent of each dollar reduction in health care spending will translate into higher wages.[25]

Gruber's New Assignment

The Clinton proposal suffered political defeat in large part because of its cost.[26] Passing reform under President Obama, then, would require a plan seen as affordable, especially since he'd vowed it wouldn't increase the federal budget deficit by "one dime."[27]

Known for proficiency in approximating CBO's analyses of health reform plans, Gruber was hired to help a second Democrat White House succeed where the first had failed: in creating legislation that CBO scored as at least deficit-neutral. Gruber apparently revived his wage growth hypothesis to make the proposal, at least on paper, look fiscally sound. Those opposed to the Cadillac tax, he told his Boston audience, are "going to have to fill a trillion dollar hole in the deficit to get rid of it."[28,29]

Wage-Benefit Tradeoffs?

To reach his wage growth conclusion, Gruber relied upon years of research into the unproven theory of compensating wage differentials, which posits that workers pay for benefit cost increases through pay reductions. Gruber then flipped the theory on its head, maintaining that it also works in reverse.

Investigations of the theory of compensating wage differentials fall into one of four categories:

- **Those finding that workers indeed suffer wage reductions when benefits costs rise.** Examples include Gruber's two studies,[23,24] Eberts and Stone in 1985,[30] and Sheiner in 1999.[31]
- **Those finding that wages and health benefits are positively correlated—workers who gain wages also gain insurance coverage (or vice versa).** Examples include Simon in 2001,[32] Monheit et al. in 1985,[33] Oyer in 2008,[34] Schwabish in 2004,[35] Browne and Trieschmann in 1991,[36] and Bernstein and Allegretto in 2006.[37]
- **Those finding mixed results.** Examples include Currie and Madrian in 1999,[38] Madrian in 2006,[39] and DeVaro and Maxwell in 2014.[40]
- **Those finding no wage-benefit relationship.** Examples include Levy and Feldman in 2001,[41] Lehrer and Pereira in 2007,[42] Abraham and Lluis in 2009,[43] Lubotsky and Olson in 2012,[44] and Smith and Ehrenberg in 1983.[45]

The dearth of evidence to support the theory of compensating wage differentials inspired Georgetown University's Ellen O'Brien to advocate that economists abandon it altogether.

> Despite decades of effort to demonstrate its validity, the empirical basis for the theory of compensating differentials remains surprisingly weak. Many empirical studies suggest that workers covered by employment-based health insurance plans earn *more*, not less, than do workers without health benefits…. But rather than reassess the theory, economists have focused on why the empirical research fails to produce the expected result [emphasis in original].[46]

However, Gruber continued to present both versions of the theory as established fact. As he explained to the 2008 Senate Finance Committee, "Both economic theory and a large body of economic evidence show that *there are no employer dollars*: the money that employers spend on insurance would otherwise just be spent on worker wages" [emphasis in original].[47]

In 2009 Gruber stated that "the available evidence clearly illustrates that there is essentially a one-to-one offset between employer insurance spending and wages. There are a number of economics studies that support this conclusion."[48]

Gruber also claimed that "using data from the JCT (Joint Committee on Taxation), I show in this memo that the high-cost insurance tax will raise net worker wages from 2013 through 2019 by *$234 billion*." He added that "the conclusion that lower employer insurance spending will lead to higher wages is *not* mere speculation: it is strongly supported by both economic theory and evidence. This is why it is the basis for the modeling done by both JCT and CBO" [emphases in original].[49]

Did Gruber really depend upon CBO/JCT for his questionable conclusion? Or did the influence run the opposite direction?

"One Man and His Model"

In 2008, CBO again embraced Gruber's theory of compensating wage differentials—and his "wage growth" hypothesis.

> [W]hen an employer offers to pay for health insurance, it pays less in wages and other forms of compensation than it otherwise would, keeping total compensation about the same…. [T]he available evidence indicates that employees as a group ultimately bear the costs of any payments an employer makes for health insurance. For a discussion of that evidence, see Jonathan Gruber, "Health Insurance and the Labor Market," in A.J. Culyer and J.P. Newhouse, eds., *Handbook of Health Economics*, vol. 1 (Amsterdam: North Holland, 2006), pp. 645–706…. CBO makes the simplifying assumption that total compensation is fixed and that changes in the costs of health insurance translate immediately into offsetting changes in wages and other forms of compensation. The JCT staff makes the same assumption.[50, 51]

CBO published a 2007 technical paper that described "the design, methodology, and basic assumptions" of its simulation model developed "to analyze an array of public policy options involving health insurance coverage." In the preface, CBO credits Gruber and two other academics with "helpful comments and feedback on the paper and throughout the model's development."[52]

The *Morning Consult* highlighted Gruber in an article on CBO conflicts of interest.[53] Gruber "served on the CBO health advisory panel in 2009 and 2010, at the same time he had a contract with the executive branch to analyze how much certain reform proposals might cost the federal government. In 2012, a *New York Times* profile of Gruber said his position as 'an adviser to the influential Congressional Budget Office' also meant he was 'perfectly positioned to advise the White House on health reform.'"[54-56]

Sen. Max Baucus (D-Mont.) corroborated Gruber's influence on CBO: "Most people think he is one of the best outside experts, Mr. Gruber at MIT. He has big computer models. He takes the CBO data and, in some respects, he has helped CBO by giving some information to CBO that it otherwise does not have."[57]

After Philadelphia financial adviser Rich Weinstein[58] broke "Gruber-Gate" last fall,[59] journalists began exploring the relationship between Gruber and CBO,[60,61] among them *The Weekly Standard*'s Jeffrey Anderson: "Two well-placed sources on Capitol Hill say that the Congressional Budget Office effectively used Jonathan Gruber's model to score Obamacare," he wrote. Another "well-placed Congressional source" reportedly confided that "two of Gruber's graduate student protégés worked on the scoring."

Anderson concluded that Gruber held sway "over the CBO, the White House, and Congress alike" and that "an overwhelming number of the ostensibly independent statements or scores that were made or published in support of Obamacare—from [Paul] Krugman, [Ezra] Klein, [Ron] Brownstein, the DNC, [Harry] Reid, [Nancy] Pelosi, [Kathleen] Sebelius, and even, to a significant degree, the CBO itself—were traceable to the support of one man and his model."[62]

Former presidential adviser and fellow ObamaCare architect Ezekiel Emanuel took Gruber's clout a step further. Gruber was hired, he wrote, "to predict the CBO score…largely because he had developed an economic model of the health care system that the CBO borrowed and refined to create its own model."[63]

Years prior, one journalist struggled to expose the relationships Anderson discovered. Jane Hamsher described Gruber's power over many in the media and the Administration.

"Gruber" she added, "is also cited repeatedly to substantiate the claim that the excise tax will result in higher wages after employers reduce benefits, because they'll pass those savings on to workers." That argument, she maintained, "flies in the face of all reason, and nobody has been able to point to a study showing that when health care costs go down, businesses mostly share those savings. Quite the contrary."[64]

The "Wage Growth" Backlash

Hamsher wasn't alone in her distrust of Gruber's assertions. Economist Lawrence Mishel directly disputed his use of trends in the late 1990s as proof of "wage growth."[65]

Gruber had written that "when firms reduce their insurance generosity, they make it up in higher pay for their workers. We saw this in the late 1990s, when the rise of managed care temporarily lowered insurance costs, and wages rose in real terms for the first time in many years. But as soon as managed care was weakened and health costs rose again, we once again saw flat or declining real wages in the United States."[66]

Mishel argued that "health care costs are not large enough to substantially move wages," and after examining wage-benefit comparisons over 1989-2007, he concluded that Gruber's "'health care theory of wage determination' is wrong, and other factors explain these overall wage trends."

The *Daily Kos* reported a study over an even longer period (1975-2008), discovering that "medical costs and wages have almost no correlation." Those hoping for a raise, the researcher wrote, should "pray for the unemployment rate to decline instead of a tax increase on your medical insurance."[67]

Health policy expert Timothy Jost and his colleague J. White contended that wage increases in the 1990s "were part of an unusual increase in total compensation that far exceeded the size of health care cost constraint." When considering the unemployment rate, they wrote, "The assumption that benefit cuts will result directly in one-to-one wage increases is heroic, to say the least. Economists assume that wages and benefits are simply interchangeable, but human resources specialists in corporations do not expect to follow the theory."[68]

Journalist Maggie Mahar also challenged Gruber's proposition:

> He must be kidding. Take a look at unemployment. Consider the state of the economy. Review average wages over the past twenty years. Do you really see employers hiking salaries? Granted, hourly wages finally began to rise in the late 1990s, but this was only after years of seeming prosperity coupled with wage stagnation. Unless the job market is very tight, employers share profits with investors long before they begin handing out raises.[69]

During an Economic Policy Institute conference call, economist Robert Reich reportedly joined Mishel in scoffing at Gruber's hypothesis. "Reich and Mishel both pushed back on the idea that employers would make up for decreasing their health care costs by increasing wages for employees. 'There's no reason to assume that wage increases will come forth, especially in the current environment, and there's no reason to suppose that wage increases would equal the amount of coverage foregone.'" Mishel reportedly said, "[E]mployers have the upper hand. If health care costs go down, employers won't raise wages in response."[70]

United Steelworkers president Leo Gerard and other labor leaders were equally skeptical. "The people who are promoting this tax say companies will make up for this with higher wages. These people who say that have never been at the bargaining table. It doesn't work that way."[71]

Larry Cohen, president of the Communications Workers of America, told *The New York Times* that "in the real world, companies cut costs and they pocket the money. Executives tell the shareholders: 'Hey, higher profits without any revenue growth. Great!'" AFL-CIO president Richard Trumka also disparaged the claim. "If you believe that, I have some oceanfront property in southwestern Pennsylvania that I will sell you at a great price." "I had to wait for him to stop laughing," said the editorialist, "to get his answer."[72]

As for business owners themselves, only 16% of those responding to a 2009 Mercer employer survey said they'd convert any cost savings into pay raises. In Towers Perrin's September 2009 survey, a paltry 9% said they expected to increase wages.[73,74]

Despite the objections, Senate lawmakers, seduced by Gruber's promise of increased tax revenue, insisted that the Cadillac tax was a dependable financing structure. And CBO provided analyses that supported Gruber's claims.

Another Architect Weighs In

Gruber's certitude about his hypothesis may have persuaded another ObamaCare author to promote it. Ezekiel Emanuel, with Victor Fuchs, wrote about the benefits of health reform in *JAMA*: "Several studies show that when workers lose employer-provided health insurance, they actually receive pay increases equivalent to the insurance premium," footnoting the claim to Eberts and Stone (see ref 30) and Gruber (see ref 24). It's important to recall that neither study addressed "wage growth," but instead wage *losses*.[75]

Emanuel later offered the proposition to a Cleveland audience: "People that get their insurance through their employer? They're gonna get a pay raise. If your employer no longer has to provide you health insurance, they're gonna raise your salary. Right?"[76]

When the audience balked at the proposition, Emanuel defended it by vaguely referring to research. "You're skeptical? First of all, like all good academics, let me retreat behind all the studies. All the studies—and I mean all the studies ever done on this topic—show that that's the case, that in fact when people switch from jobs that have health insurance to jobs that don't, an equivalent full dollar-for-dollar payment. And I'd be happy to provide you with all the citations."[77]

Did Gruber Believe in "Wage Growth"?

In early January 2010, Gruber conceded that while "'in the mid- and late-1990s, when we got health costs under control, wages rose nicely,'... other factors could have also lifted wages during that period."[78]

Days later, Mishel in a blog posting wrote that "Gruber clearly overreached with the argument about health care driving wage trends and has acknowledged that to me privately (yesterday)."[79]

And when asked about economists who, considering the slack labor market, "doubt that employers would shift savings from health care into wages," Gruber "dismiss[ed] these concerns," and reiterated that the tax would induce companies to offer less costly plans. "There's literally no evidence out there that people are going to suffer," he added.[80]

How Will the Tax Affect Workers?

While Gruber's first assertion is indisputable, his second is not. Employers have no choice but to reduce plan benefits. But as Jost and White,[68] Wheeler,[78] and others warned, employees' health outcomes could worsen if they avoid healthcare due to cost increases.[81]

Today's employer-sponsored health insurance, according to a *USA Today* article, "often requires workers to pay so much out-of-pocket that many feel they must skip doctor visits, put off medical procedures, avoid filling prescriptions, and ration pills."[82]

In its June report, PricewaterhouseCoopers found that more workers are forgoing care (40%, up from 29% in 2009); over that time frame, the number of companies offering high-deductible plans has almost tripled, and the average employer-sponsored insurance deductible has almost doubled. More than 85% of employers "have implemented, or are considering, greater employee cost-sharing. And 25% of employers have already implemented high-deductible health plans as the only benefit option to their employees, a 40% increase over 2014."[83]

And Wage Growth?

A recent *Wall Street Journal* report finds that wages are still stagnant.[84] Goldman Sachs analysts, however, believe that the excise tax—and the opportunity to send workers to the ObamaCare Exchanges—may prompt businesses to gradually begin offering pay raises.

Such wage hikes may prove disappointing, however. Reduced benefit costs, Goldman Sachs projected, could produce an annual wage growth rate of 0.15% (15 cents for every $100 in salary).[85]

In 2009, Jeanne Sahafi of *CNN Money* wondered about the credibility of the wage growth hypothesis. "Sound implausible? Well, there doesn't seem to be much precedent," she wrote. When she asked "a handful of economists and tax experts" to report any example of firms converting savings to worker pay, "no one could recall a specific instance." She posited that the tax could result in "higher health costs and no wage increase."[86]

Columnist Megan McArdle, writing for *The Atlantic*, questioned wage growth as a financing scheme:

> As revenue-raising mechanisms go, this is pretty indirect. And with so many links in the chain, you can see lots of places where this could go wrong. What if employers just cut their costs and don't raise their employees' wages? What if employers just cut their costs and don't raise their employees' wages, because they're in a dying unionized industry? What if they shift workers to other forms of tax-deferred compensation, like 401(k) matching or HSAs? What if smart lawyers figure out a way to structure health plans to avoid the tax? What if all the people who leave employer insurance for the exchange, or have their benefits cut, are low wage workers with low marginal tax rates?… I can see the logic here, and it's very compelling as economic theory. But it's not exactly revenue I want to *count* on [emphasis in original].[87]

The Case for Transparency

The "wage growth" dispute among unions, economists, and employers will likely continue, as it has, on the sidelines. That this debate has been largely esoteric highlights just how uninformed the public was kept about the so-named Patient Protection and Affordable Care Act.

The roughly 150 million Americans covered through employment weren't told their tax-free benefits were being targeted nor that the Cadillac tax presented powerful incentives for companies to drop plans. They weren't aware that the tax was designed "to eventually force every American with employer-based coverage onto the Exchanges whether they like it or not."[88] Instead, Gruber, the Administration, Congress, and the media maintained that ObamaCare would leave employer-sponsored health insurance protected.

We now know that employer-sponsored coverage is being intentionally eroded, and that employees are paying more for care that was much more affordable before the Affordable Care Act. In response, millions more are avoiding treatment and rationing medicine.

Such sacrifice was confidentially considered necessary to finance the overhaul. But no one told the American worker.

The public also didn't know that the law's funding was based in part on suspicious premises that one admittedly self-important man[89] peddled to those in power, a man who also confessed that the law's redistributive mechanisms would have never been accepted had they been common knowledge.[90]

Armed with the truth about ObamaCare, Americans might have taken this information into the voter's booth with them in 2010 and beyond.

Prior to ACA, Gallup found 80% of Americans were "satisfied with the quality of medical care available to them, including 39% who are very satisfied," while 61% percent were "satisfied with the cost of their medical care, including 20% who are very satisfied."[91] Today this law continues to be unpopular, with 47% expressing disapproval.[92] Perhaps ObamaCare would be more appealing if Americans weren't regularly blindsided by its repercussions.

In his ACA comic book or "graphic novel"[93] (see Figures 2 and 3), Gruber asks us to rely on CBO for our confidence in the law: "There are risks. But we have the benefit of the independent projections of the CBO…to suggest that this should work out."

Figure 2. "Risks" from the Gruber Comic Book. Image scanned from Gruber J. *Health Care Reform: What It Is, Why It's Necessary, How It Works*, illustrated by Nathan Schreiber, published by Hill and Wang, a division of Farrar, Straus and Giroux.

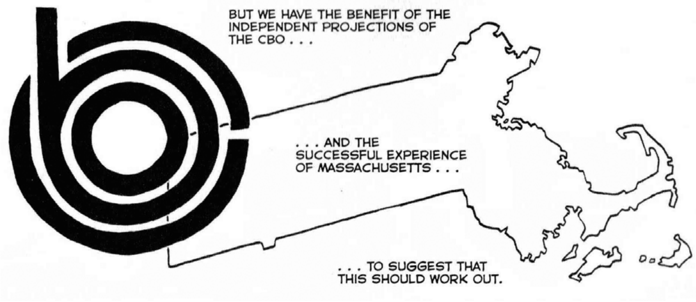

Figure 3. "CBO Projections" from the Gruber Comic Book, cited *supra* in Figure 2.

We now know that Gruber's "independent" CBO was, by all appearances, heavily influenced by his assumptions—and the risks are therefore quite troubling. If "wage growth" doesn't materialize as he promised, Congress passed a reform bill the country can't afford.

Perhaps the only silver lining to the Gruber-CBO affair is that we learned of the need for greater accountability at CBO. Amid calls to "clean house" for its employment of "Gruber's deceptive modeling methods," the body began developing a conflict-of-interest policy in late 2014, and a new director was appointed last February.[94-96]

However, CBO continues to bank on the Cadillac tax's "wage growth" potential. Recent analysis found that an ACA repeal would increase the federal budget deficit, in part due to loss of tax revenue from worker pay raises. But if "wage growth" is a specious concept, as many maintain, wouldn't repeal instead be "deficit-friendly"?[97]

Columnist Ben Domenech writes: "The real issue with CBO is the black-box nature of many of its assumptions." He and others advocate that CBO adopt "open source" methods to provide greater transparency about its assumptions and to test new ones.[98,99]

"Throughout the whole political spectrum nearly everyone regards their own conclusions as 'objective' and supported by the evidence," writes Mercatus Center's Charles Blahous. "A good CBO director needs to be self-aware enough to understand the power of this delusion, and to continually invite challenge to his own analytical conclusions as well as those of his agency."[100]

The Congressional Budget Office was created in 1974 to serve Congress and check the powers of the executive branch. It's time that legislators ask CBO to revisit Jonathan Gruber's wage growth promises.

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