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Fact Sheet for the Chairman, Subcommittee on Health, Committee on Ways and Means, House of Representatives

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EARLY RETIREE HEALTH

Health Security Act Would Shift Billions in Costs to Federal Government

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Health, Education and Human Services Division

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The Honorable Fortney H. (Pete) Stark
Chairman, Subcommittee on Health
Committee on Ways and Means
House of Representatives

Dear Mr. Chairman:

Company-sponsored health plans play a major role in providing retirees and their dependents with access to medical services. We estimate that about 9 million private sector retirees and one-third of all private sector workers are in company health plans with retiree coverage. Such care has become a major concern because of demographic and economic trends. Retiree health care costs have grown, in part, because there are more retirees than ever before--workers retire earlier and live longer. Also, medical cost inflation is outpacing general inflation by over 3 percentage points annually. The combination of more retirees receiving higher cost medical care is straining companies' resources.[1]

This fact sheet responds to your request for information on the financial costs to U.S. companies of providing retiree health care under the President's Health Security Act (HSA).[2] As agreed with your staff, we developed information on (1) projected costs of early retiree (retirees between ages 55 and 64) health benefits, (2) estimated federal government costs, and (3) companies' and early retirees' savings for these benefits under HSA. We did not estimate HSA's effects on costs or savings for early retirees covered by government-sponsored health plans. Nor did we attempt to estimate the combined impact of the retiree health provisions in HSA and other HSA provisions on companies' costs.

In addition to HSA, a wide range of health care proposals have been introduced into the Congress recently. Each of

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[1]Retiree Health Plans: Health Benefits Not Secure Under Employer-Based System (GAO/HRD-93-125, July 9, 1993).

[2]S. 1757, H.R. 3600.

these proposals deals with early retiree coverage in one way or another. The information we provide on the costs of early retiree health benefits is pertinent to the upcoming debate of these alternative health care reform proposals.

We used output from our model of retiree health costs and liabilities to describe projected aggregate retiree health costs.[3] Provisions from HSA were used to make detailed breakdowns of expenditures by companies, retirees, and the government. All data are reported for the aggregate group of companies with retiree health benefits. Annual costs are expressed in nominal dollars. To make interpreting the information easier, the projected costs are presented in a table format accompanied by brief narrative descriptions in the sections that follow.

These data show the costs for company-sponsored retiree health benefits for 1998 and beyond, and what expenditures would be for early retirees, companies, and the federal government if HSA were enacted.[4] We also estimate what these costs and savings would be over the first 10 years that HSA would be in effect.

The following major changes in the financing of early retirees' health care would occur under HSA:

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[3]See Employee Benefits: Companies' Retiree Health Liabilities Large, Advance Funding Costly (GAO-HRD-89-51, June 1989). The model was used to estimate the effect of legislation on companies' costs and liabilities. See our testimonies, Significant Reductions in Corporate Retiree Health Liabilities Projected if Medicare Eligibility Age Lowered to 60 (GAO/T-HRD-92-7, Nov. 5, 1991) and Employee Benefits: Companies' Retiree Health Liabilities Large, Even With Medicare Catastrophic Insurance Savings (GAO/T-HRD-89-29, June 14, 1989).

[4]As noted in our prior report, Retiree Health Plans: Health Benefits Not Secure Under Employer-Based System, a number of U.S. circuit courts of appeals have generally held that an employer may modify or terminate retiree health benefits for current and future retirees if the company reserved its right to do so in benefit plan documents or collectively bargained agreements. Whether the enactment of HSA would affect the legal right of specific employers to terminate their retiree health coverage may ultimately be determined by the courts on a case-by-case basis.

-- Savings would be generated for both companies and their retirees because HSA would shift to the federal government three-fourths of company costs, on average, and would relieve covered early retirees of any charges beginning in 1998. Under current rules, early retirees on average pay about 20 percent for health benefits and companies, 80 percent. Beginning in 1998, early retirees with company-sponsored benefits would, on average, realize a substantial savings on their health benefits premiums (see fig. 1 for the relative shares). Starting in that year, companies would pay 20 percent of their early retirees' health benefit costs plus a transition assessment during 1998 through 2000 (see sec. 1, table 1.1). The federal government would pay the remainder. After the year 2000, when the transition assessment would end, companies would pay 20 percent and the government, 80 percent.

-- Given that it does not pay any premiums for early retirees in the current system, the federal government would have its financial commitments increase substantially under the proposed HSA (see fig. 2). For example, in the first 10 years of the act's implementation the government would spend $184.5 billion for early retiree health costs (see sec. 2, table 2.1). In 1998, if the act becomes effective, the government would spend approximately $6 billion for early retiree health benefits. In 2001, after the 3-year assessment period ends, the federal share would nearly triple to $16.7 billion.

-- Companies would save $133.4 billion in the first 10 years following HSA's enactment (see table 2.1). During the first 3 years, companies would save over $11 billion and in the first 5 years, over $37 billion. After 10 years, companies would save over $130 billion. Companies' savings would be lower in the first 3 years because of the assessment they would pay during the transition years, 1998 to 2000.

-- Companies' accrued liability for their active workers who will retire early and early retirees receiving health benefits would drop by about $188 billion in 2001 (see sec. 3, table 3.1). Companies would realize an increase in their net worth if the accrued liability for early retiree health benefits were ultimately removed through (1) enactment of HSA and (2) the termination of employer responsibility for such benefits. The accrued liability for the early retirees who we project would be receiving benefits in 2001 would fall by $44 billion (75 percent).

In summary, if HSA is enacted, beginning in 1998, early retirees with company-sponsored health plans would pay nothing for their health benefits. That year, the federal government would not only pick up retirees' share of their health costs, but would also pick up the major portion of companies' costs. The federal government's share would be $6 billion in the first year, growing to nearly three times that amount 3 years later. On the other hand, companies would save $11 billion in the first 3 years after HSA's implementation and over three times that amount 2 years later, ultimately saving over $130 billion after 10 years. Companies' accrued liability for their active workers projected to retire early and early retirees would fall by $188 billion in 2001, 3 years after HSA's implementation, thus increasing those companies' net worth.

Figure 1: Current and Future Shares of Early Retirees' Health Care Costs, 1993-2007

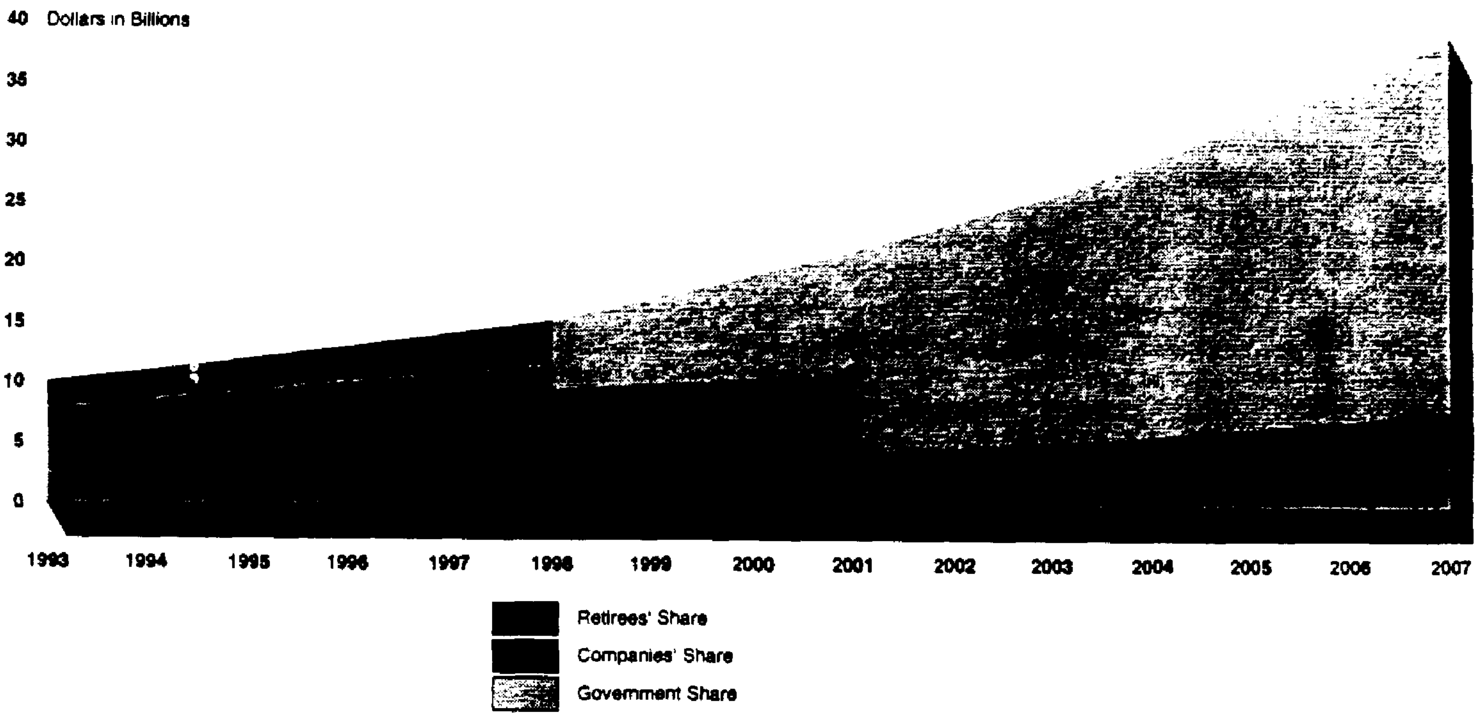
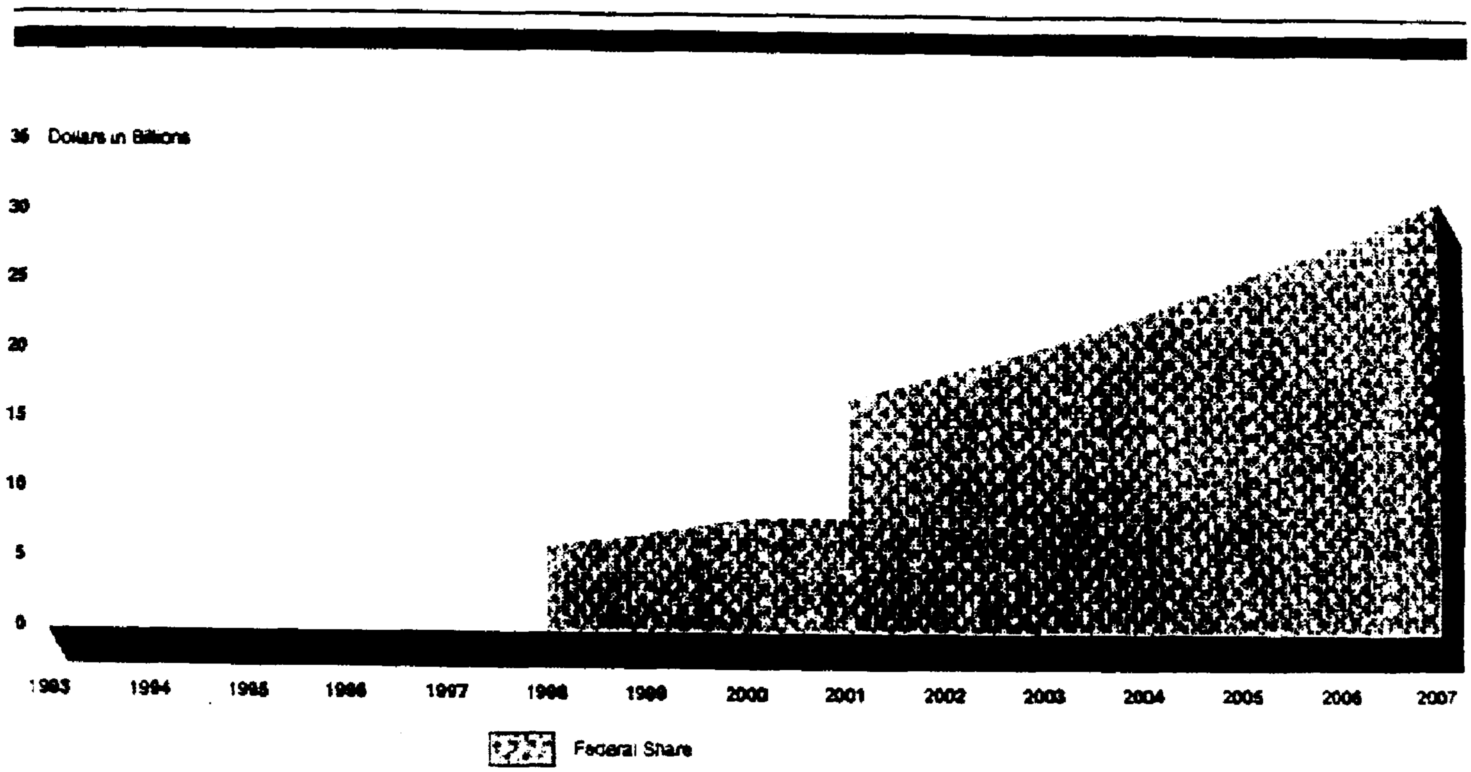


Figure 2: Federal Share of Health Coverage Costs for Early Retirees Under HSA, 1993-2007



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As arranged with your office, we will distribute copies of this fact sheet to selected congressional committees and subcommittees and make it available to others.

This information was prepared under the direction of Donald C. Snyder, Assistant Director, Income Security Issues, who may be reached at (202) 512-7204 if you or your staff have any questions. Carolina Martinez, Evaluator-in-Charge, also contributed to this report.

Sincerely yours,

Joseph F. Delfico

Joseph F. Delfico
Director, Income Security Issues

CONTENTS

ABBREVIATIONS

CPI Consumer Price Index
CPIMC Consumer Price Index for Medical Care
HSA Health Security Act

SECTION 1
RETIREE HEALTH CARE COSTS AND LIABILITIES

Many large companies finance all or part of the health care costs of their early retirees, including those who retiree before age 65 before they are eligible for Medicare. The growing cost of providing retiree health care benefits to current employees has raised questions about the security of retiree health benefits and companies' ability to pay future costs. The accrued liability for these benefits was $412 billion in 1993, up from $227 billion in 1988.[1] We estimate that companies' accrued liabilities for retiree health benefits will grow to $818 billion by 2001 (see sec. 3, table 3.1).

Much of companies' annual cost for retiree health benefits is incurred for early retirees. Specifically, the cost for an early retiree is over three times the cost of a retiree eligible for Medicare because companies are the secondary payer for retirees aged 65 and over. We estimate that in 1993 approximately 39 percent of retirees covered by these plans were under age 65 and not yet eligible for Medicare. The accrued liability for these early retiree health benefits was $127 billion in 1993.

HSA PROVISIONS

The Health Security Act would set up a system of managed competition through regional and corporate alliances. It would also require employers to pay a portion of employee health premiums, establish a standard benefits package, and set a national budget target to control health care costs.

Most important in terms of this report, HSA contains a provision to cover early retirees aged 55 to 64 who are not eligible for Medicare.[2] Under that proposal, retired workers aged 55 to 64 would receive health care coverage through regional alliances and would pay only 20 percent of the total premium required to finance the coverage. However, companies would be responsible for paying that 20-percent share for their early retirees if they were providing those retiree health benefits as of October 1993. The federal government would pay the remainder. Lastly, HSA requires companies to pay an assessment for 3 years based on whichever is higher: 50 percent of their savings under HSA or 50 percent of their adjusted costs (see table 1.1). The adjusted costs are

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[1]See appendix IV of Employee Benefits: Companies' Retiree Health Liabilities Large, Advance Funding Costly for a detailed description of the methodology and data used to make the original estimate of companies' liabilities.

[2]See title VI, section 6114, in H.R. 3600, the Health Security Act of 1993, by the 103d Congress, 1st Session.

calculated by increasing companies' 1993 costs by the Consumer Price Index for Medical Care.[3]

Table 1.1: Assessment Calculation for Companies With Retiree Health Plans in 1993

Dollars in billions

Year	Adjusted base period retiree health costs	50 percent of adjusted costs	50 percent of companies' savings
1993	$7.9		
1994	8.6		
1995	9.3		
1996	10.1		
1997	11.0		
1998	11.9	$6.0	$4.6
1999	12.9	6.5	5.1
2000	14.0	7.0	5.7

LARGE SAVINGS FOR RETIREES AND COMPANIES FROM HSA

HSA's provision for early retirees would generate large savings for both companies and retirees. These savings result because the proposal shifts to the federal government three-fourths of company costs, on average, and relieves retirees who have company-sponsored retiree health benefits of any cost. Currently, early retirees pay, on average, about 20 percent of retiree health care costs and companies, 80 percent. Beginning in 1998, when the transition assessment would begin, companies would pay the assessment cost plus their 20-percent share of retiree health care costs. With the implementation of HSA, which would take full effect in 2001, the federal government would pay 80 percent of the cost of early retiree health coverage, while companies would only pay the remaining 20 percent.

[3]This provision is in title VII, section 7121, in H.R. 3600, the Health Security Act of 1993.

SECTION 2
FEDERAL GOVERNMENT COSTS
WOULD GROW BY BILLIONS UNDER HSA

In the first 10 years under HSA, the federal government would pay $184.5 billion for the cost of early retiree health care (see table 2.1). These payments would increase gradually in the first 3 years. For example, the government would pay out $21 billion after the first 3 years of HSA's implementation, but a total of approximately $56 billion in the first 5 years.

RETIREE HEALTH COSTS WOULD SHIFT UNDER HSA

If HSA became effective in 1998, the total cost for early retiree health coverage would be $15.1 billion. Early retirees with company-sponsored benefits would realize a substantial savings by not paying any of their health benefit premiums (see table 2.1). Of those costs, companies would pay $9 billion ($6 billion in assessments and $3 billion for their 20-percent share); the government would pay the remainder, $6.1 billion. While companies would be paying significantly more than the government at this point, they would still have a net saving of $3.1 billion. These companies would continue to pay 20 percent plus the assessments through the year 2000. Beginning in 2001, the federal government would pay the full 80 percent of the costs of early retiree health care, $16.7 billion.

Table 2.1: Early Retirees', Companies and the Federal Government's Current and Future Costs of Health Coverage

Dollars in billions

Year	Early retiree benefit cost	Retirees' share	Companies' share	Federal share	Companies' net savings
1993	$9.9	$2.0	$7.9	0	0
1994	10.9	2.2	8.7	0	0
1995	11.9	2.4	9.5	0	0
1996	12.9	2.6	10.3	0	0
1997	14.0	2.8	11.2	0	0
1998	15.1	0	9.0	$6.1	$3.1[a]
1999	17.0	0	9.9	7.1	3.7[a]
2000	18.9	0	10.8	8.1	4.3[a]
2001	20.9	0	4.2	16.7	12.5
2002	23.3	0	4.7	18.6	13.9
2003	25.6	0	5.1	20.5	15.4
2004	28.6	0	5.7	22.9	17.2
2005	31.9	0	6.4	25.5	19.1
2006	35.0	0	7.0	28.0	21.0
2007	38.8	0	7.8	31.0	23.2
10-year total	$255.1	$0	$70.6	$184.5	$133.4

[a]Companies' savings in 1998-2000 after assessment is paid.

The costs to the federal government of providing early retiree health benefits would increase from zero in 1997 to a total of $184.5 billion 10 years later (see table 2.1). The government's share of the costs of providing these benefits is projected to increase slightly during the 3-year assessment, from $6 billion in 1998 to over $8 billion in 2001. Beginning in 2001, the federal share of early retiree health coverage would double from $8.1 billion to $16.7 billion, thus nearly tripling annual costs since the first year of HSA's implementation.

COMPANIES WOULD SAVE BILLIONS UNDER HSA

In contrast to its impact on the federal government's increased costs, HSA's early retiree provision would result in significant cost savings for companies in the act's first 10 years. Like the federal government's costs, the companies' savings would increase gradually in the first few years. For example, companies would save $11.1 billion during the first 3 years of HSA's implementation, but a total of $37.5 billion after the first 5 years (see table 2.1). Companies' savings would be lower in the first 3 years because of the assessment they would be required to pay during the transition from 1998 to 2000. However, after 10 years, companies would save over $133 billion.

Early retirees' savings would increase by the rate of medical inflation after 1997 if HSA were implemented. Covered retirees would save $10.3 billion in the first 3 years and $19.2 billion after the first 5 years.

SECTION 3
COMPANIES' NET WORTH COULD INCREASE UNDER HSA

Large companies are the principal sponsors of retiree health coverage. Although only about 4 percent of all companies provide retiree health coverage, approximately one-third of all private sector workers are in company health plans with retiree coverage.[1]

Under Financial Accounting Standards Number 106, "Employers' Accounting for Post-Retirement Benefits Other Than Pensions," employers have to report the cost of postretirement benefits over the period employees earn them. Balance sheets must be made more informative and more complete by including a measure of the obligation to provide postretirement benefits.

We estimate that in 1993, companies paid over $13 billion of retirees' health care costs and had $412 billion in accrued retiree health liabilities (see table 3.1). That figure is projected to increase to $818 billion by 2001 if the current system remains unchanged. Because HSA could remove three-fourths of company costs for retiree health care during the 3-year assessment period, companies could begin reporting an increase in their net worth on their balance sheets in 1998. Our estimates show that companies' accrued liabilities would fall to $630 billion in 2001 when HSA would become fully effective. This 23-percent reduction in liabilities would give companies an increase in net worth of $188 billion, other things remaining constant. Similarly, the accrued liabilities for the early retirees who we project would be receiving benefits in 2001 would fall by $44 billion (75 percent).

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[1]Retiree Health: Company-Sponsored Plans Facing Increased Costs and Liabilities (GAO/T-HRD-91-25, May 6, 1991).

Table 3.1: Companies' Retiree Health Costs and Liabilities in 1993 and 2001

Dollars in billions

	Companies' benefit cost		Companies' accrued liability					
Year	Current retirees		Current retirees		Future retirees		Total amount accrued for retirees	
	All	Early	All	Early	All	Early	All	Early
1993	$13.7	$7.9	$155	$29	$257	$98	$412	$127
2001 without HSA	28.8	16.7	313	59	505	192	818	251
2001 with HSA	16.3	4.2	269	15	361	48	630	63
Increase in companies' net worth							$188	

SCOPE AND METHODOLOGY

We used our 1988 projections of the future costs of early retiree health benefits to provide the projected costs under the proposed Health Security Act of early retiree health benefits and to estimate companies' and early retirees' savings and federal government costs for these benefits. It should be noted that the methodology assumes that the federal government would assume responsibility for retiree health benefits. A determination of whether a specific employer may be relieved of its responsibility to provide retiree health benefits or the accounting of such benefits under Financial Accounting Standards Number 106 may be affected by particular court decisions or guidance subsequently provided by the Financial Accounting Standards Board.

Our estimate of retiree health liabilities made in 1988 was based on a projected stream of benefit payments that sponsors would pay into the next century. The forecast used assumptions that have since proven to be true, so we believe the original forecast is still valid.

To arrive at values for our 1988 baseline estimate of companies' liabilities, we reviewed and combined information from a number of sources to model retiree health liabilities originally estimated by the Department of Labor.[1] Our model's output of retiree health liabilities and funding costs depended on a variety of demographic, economic, and actuarial assumptions. For example, we needed to estimate (1) the ages and numbers of covered workers and early (under age 65) and normal retirees (because their health care costs are different), (2) companies' past and projected average costs of providing health benefits to early and normal retirees, and (3) future mortality rates and medical cost inflation. The stream of estimated future benefit payments was discounted to obtain the present value of these liabilities.

We analyzed provisions of HSA to develop estimates of the costs of early retiree health care shared by companies and the federal government beginning in 1998. We did not estimate HSA's effects on costs or savings for early retirees covered by government-sponsored health plans. Nor did we attempt to estimate the combined effect of all HSA provisions on companies' costs.

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[1]U.S. Department of Labor, Pension and Welfare Benefits Administration, Employer Sponsored Retiree Health Insurance, May 1986, appendix D.

CURRENT COSTS OF HEALTH BENEFITS FOR RETIREES

The cost of providing retiree health benefits varies considerably among companies in part because of differences in the average age of retirees. Companies with a higher percentage of retirees aged 65 and older tend to have lower costs because Medicare covers a substantial portion of the medical costs for these persons. Large companies are the principal sponsors of retiree health coverage. While only about 4 percent of all companies provide retiree health coverage, approximately one-third of all private sector workers are in company health plans with retiree coverage.[2]

RECENT AND PROJECTED MEDICAL COST INFLATION

Companies' average retiree health costs have risen more than all other prices on average. These historically higher costs have resulted from increases in medical personnel and supply costs, new and expensive technology, and higher utilization. Because of the rapid development of these factors and expectations by some experts that medical expenditures will continue to grow as a share of total output, companies' costs of providing health benefits to retirees are expected to continue to rise faster than general inflation.

To estimate the differential growth of retiree health costs, we used the difference between the Consumer Price Index (CPI) and the Consumer Price Index for Medical Care (CPIMC). CPI, which measures general inflation, is based on prices of several household budget items, including food, transportation, housing, and medical care. CPIMC measures medical inflation--it represents the price of a market basket of medical goods and services. CPIMC averaged 2.3 percentage points more per year than CPI in the 1960s and over 4 percentage points more per year in the early 1980s. Most recently (1989 to 1993), this difference was 3.6 percentage points as CPI averaged 4.1 percent growth per year, while CPIMC grew by an average rate of 7.7 percent per year (see table I.1). To forecast retiree health costs from 1988 forward, we assumed a difference in medical and general inflation of 3.5 percentage points. The actual difference in general and medical inflation averaged approximately what we assumed it would during the first 5 years of our forecast, so we believe that using the output of our earlier estimate is appropriate for the purpose of answering Representative Stark's request.

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[2]Retiree Health: Company-Sponsored Plans Facing Increased Costs and Liabilities.

Table I.1: General and Medical Cost Inflation, 1989-1993

Percentage change

Year	CPI	CPIMC	Difference
1989	4.8	7.7	2.9
1990	5.4	9.0	3.6
1991	4.2	8.7	4.5
1992	3.0	7.4	4.4
1993	3.0	5.9	2.9
Average 1989-1993	4.1	7.7	3.6

Source: Monthly Labor Review, Bureau of Labor Statistics, March 1994.

In addition, the number of retirees and spouses covered by company retiree health plans is slowly increasing. Over the next 10 years, we expect about a 2.8-percent annual increase in the number of persons covered by company retiree health plans and a 1.9-percent annual increase in the number of retirees receiving health benefits.

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