Research

TaKing Stock: The Potential Impact of King v. Burwell

BRITTANY LA COUTURE, DOUGLAS HOLTZ-EAKIN | MAY 13, 2015

EXECUTIVE SUMMARY

The Supreme Court's pending decision in King v. Burwell could upend the way premium subsidies are distributed through the federal health insurance exchanges in as many as 37 states. The impacted states are those that declined or failed to establish their own exchanges under the Affordable Care Act (ACA). Examining the insurance market effects we find that:

In addition, such a decision would tend to reverse the damaging labor market impacts of the ACA. Our analysis indicates that these impacts would be:

INTRODUCTION

King v. Burwell, which was argued before the Supreme Court in March 2015 and will likely be decided in June 2015, poses a question of statutory interpretation. The plaintiffs argue that the text of the ACA should be read literally: it only authorizes premium subsidies for people in "exchanges established by the State under §1311." A separate section, §1321, describes the establishment of a federal exchange by the Secretary of Health and Human Services (HHS) if the state does not create its own exchange. A rule issued in 2012 by the Internal Revenue Service (IRS) allowed premium subsidies to be paid through exchanges

established by the Secretary, but plaintiffs argue these subsidies are illegal since there is no congressional authorization for that spending.

If the plaintiffs are successful, the immediate effect will be to stop the flow of premium subsidies to states that have not established their own exchange. A secondary effect will be that many individuals in those states will be exempt from the individual mandate penalty because without the subsidies, they will qualify for an affordability exemption. Likewise, all employers in states without state-established exchanges will be exempt from the employer mandate penalties, which are only triggered if an employee receives a federal tax subsidy for health insurance through an exchange. This will cause a fundamental shift in the economies of the "*King* states" by altering the way insurance is bought and sold, and by redefining the relationships between employers and employees.

METHODOLOGY

In determining how to address the questions presented by a possible ruling in favor of the plaintiffs in *King*, we had to make some simplifying assumptions. First, we assumed that no federal congressional action would be taken between the announcement of a ruling in *King* and the beginning of the 2016 open enrollment season; in reality there is every indication Congress would take *some* action, but it is impossible at this stage to predict what it would be. Second, when considering the effects on employers and employees, we assumed that all employees are residents of the state in which they are employed. We rely loosely on the assumption that the Supreme Court would stay a ruling for 3-6 months to give states and the administration time to react to the consequences of its ruling. Finally, we assumed that the language limiting the permissible establishment of §1311 exchanges to dates before January 1, 2014 would not be enforced and that the states would be afforded an opportunity to establish exchanges in the future, particularly if the ruling in *King* is favorable to the plaintiffs; the legality of this non-enforcement may ultimately be settled by subsequent litigation.

INDIVIDUAL MARKET EFFECTS

A ruling for *King* would bring about changes in the individual market with myriad impacts on various stakeholders, including newly-insured individuals, previously-insured individuals, and individuals facing tax penalties as a result of the ACA.

Should the plaintiffs in *King* win, around 6.6 million people would lose their health insurance subsidies.[1][1] This is about 87 percent of the total enrolled population of the federal exchanges as of February 22, 2015. Of the states with federal exchanges, however,

there will be significant geographical differences in the impact on individuals. For instance, about 92 percent of enrollees in North Carolina's exchange are subsidized while 71 percent of New Hampshire's exchange enrollees are subsidized.

There are also significant differences in the value of the subsidies in different states. In the 2015 enrollment year, the average annual tax subsidy received in the federal exchanges will be approximately $3,156, or $263 per month, yet there is significant geographical variation among states.[2] For example, in Arizona, the average annual subsidy is only $1,860 while it is $6,408 in Alaska. Alaska, however, is an outlier with unique geographical and demographic characteristics that drive up costs in that state; the next highest average subsidy is $5,040 followed by $4,236 in Wyoming and Mississippi, respectively.

Many individuals that lose access to a premium subsidy will likely continue to purchase insurance, either by paying a higher price for their current plan or by switching to cheaper insurance. In 2014, the McKinsey Institute estimated that about 74 percent of exchange enrollees were insured before passage of the ACA, which indicates that these individuals would be able to purchase insurance post-*King* as well, if they were so inclined.[3] It is important to keep in mind, however, that the Essential Health Benefits and mandatory community rating attendant on the ACA's Qualified Health Plan requirements have made previously-available insurance plans unavailable or unaffordable to many, which may reduce re-uptake.

Despite obstacles to gaining insurance imposed by the ACA, most subsidized individuals would still be able to access insurance post-*King*. Immunity from the individual mandate will allow individuals over 30 years old to enroll in catastrophic plans, which is currently penalized by the mandate under the ACA. These plans have lower actuarial value than the "metal-tiered" plans of the ACA, but actuarial value does not measure quality of coverage, rather the expected ratio of dollars paid out-of-pocket to dollars paid by the insurer to cover the cost of care.

Many individuals living in states that will be impacted by the *King* decision will be exempted from the individual mandate and its tax penalty. Under the ACA, a household is not required to pay the penalty if the lowest cost health insurance plan available is more than 8 percent of household income. Without subsidies, many households will newly fall into this exemption category. These households will be freed from the burden or threat of the tax, which will average about $1,200 for this population in 2015.[4] In total, 11.1 million individuals will no longer face the threat of a tax penalty. Absent the subsidies, most exchange enrollees would be exempted from the threat of this penalty, and those not exempted would have incomes approaching 400 percent of the Federal Poverty Level.

The individual mandate penalty is not the only tax headache that could be avoided however. It is estimated that in 2014, about 50 percent of individuals who purchased insurance through the exchanges and received subsidies will have to repay some portion of those subsidies through their taxes. These 3.85 million or so individuals, on average, will owe the IRS around $794.[5] Should King win, however, these people will not face this problematic tax-season surprise.

Individuals will also have new incentives in *King* States. Because premium subsidies available through the ACA increase the value of not working, the Congressional Budget Office (CBO) estimates that over 2 million workers will be drawn out of the national labor force. If the Court rules in favor of *King*, the American Action Forum (AAF) estimates that 1.27 million workers will be added to the labor force by 2017.[6]

EMPLOYER MARKET EFFECTS

A ruling in favor of the plaintiffs in *King* would have implications for the employer market as well. Since the employer mandate will be unenforceable, some employers may drop insurance coverage for their employees.

In the 37 states that are likely to be impacted by *King*, about 95 million people are covered by employer-sponsored insurance. However, 96.1 percent of large employers and 60 percent of all employers offered insurance before the employer mandate went into effect. [7] These employers are unlikely to drop coverage for their employees regardless of the outcome in *King*. Some reports suggest that the average number of firms offering employer sponsored insurance is statistically unchanged even after the mandate went into effect.

Because they will not be subject to the mandate, small to medium size employers may expand employment to more people, or allow their employees to work more than 30 hours per week. AAF estimates that there are currently about 3.3 million part-time workers in the states affected by the ruling who are seeking but are unable to find full-time employment.[8] Others have estimated that at least 20 percent of businesses cut hours for workers in 2013, in part to remain below the 50 employee threshold that triggers the employer mandate.[9]

Currently there are about 261,844 employers in the 37 *King* states that are subject to the mandate penalty, 146,407 of which are medium-sized employers, who were the most impacted by the employer mandate. Absent the administrative and financial burdens imposed by the ACA mandates, the recent trend away from full-time hiring that has cost Americans more than 350,000 jobs—237,000 of which are in *King* states—may be reversed and these and countless other small employers may begin hiring more full-time workers.

HOW STATES MAY REACT

It is not completely clear which states the ruling in *King* would apply to. It is possible that it will be enforced in all states with any measure of reliance on the federal exchange platform (currently 37 states). The ruling may only be applied to states that have never had their own platform, exempting states that established exchanges and then switched, such as New Mexico and Nevada, from the effects of the ruling. It is also possible that *King* will only apply in states that have not passed legislation or executive orders attempting to create exchanges, which means that the 8 hybrid exchanges will be exempted. The Secretary of HHS has the authority to deem which states have exchanges "established by the State under §1311," and her decision will likely reflect what the states want. The inevitable objections to her determinations will eventually have to be settled in the courts if no legislative fix is offered.

Assuming that all 37 possible states are subject to the ruling, there will likely be four main categories of responses to the ruling.

Some states that were politically, financially, or technologically unable to establish their own exchanges in 2013 may attempt to do so before the next open enrollment period. For instance, in Delaware, Democrats have unified control of both the Governorship and the legislature, and could therefore be among the first to attempt and subsequently establish its own exchange. Iowa, Maine, Montana, New Hampshire, New Jersey, Pennsylvania, and West Virginia all have Democrats in control of either the Governor's mansion or the legislature, either of which could initiate the establishment of exchanges in those states if that appeared to be the course of action that enables the continued flow of subsidies. Despite cautionary tales from states with failed or unstable state based exchanges, this endeavor could be facilitated by innovative private companies that are already offering to sell or rent states the technology needed to quickly take over control of their own "pre-fab" state exchanges.

On the other hand, some states have passed legislation which precludes the establishment of an exchange. Of course, subsequent legislation can always repeal previous laws, but laws preventing the establishment of exchanges, known as Health Care Freedom Acts, have the power to prevent governors from establishing an exchange by executive order. Governors in Georgia, Louisiana, Missouri, Utah, and Virginia will all need legislation to be passed by their legislatures before an exchange may be established.

Taking this concept a step further, Alabama, Arizona, Ohio, Oklahoma, and Wyoming have passed Health Care Freedom Amendments to their state constitutions. This means that in order for these states to establish exchanges, they must meet the enhanced constitutional

threshold for an amendment, rather than just reach a simple majority required to pass a typical bill. Because of this rather large obstacle, it is less likely that these states will succeed in any attempts to establish exchanges, especially not before the 2016 open enrollment period.

Obstacles to establishment aside, some states are unlikely to even try to establish exchanges, instead taking advantage of the tax exemptions the *King* ruling would apply to the states' citizens and businesses. For example, during the debate of whether to establish an exchange back in 2012, Indiana Governor-elect (now Governor) Mike Pence cited the employer mandate exemption and its benefits to Indiana's labor market as a specific reason for why the state should not establish an exchange. Other governors and state legislatures will again face the decision of whether to establish an exchange, and this time, they will have the guarantee of knowing that by not establishing, they can help create job growth in their states.

LONG-TERM EFFECTS

Many of the effects of the decision in *King* will not be immediately apparent. That said, there will be longer term changes in the individual insurance market, labor market, as well as the way insurance plans are designed.

In a post-*King* world, individuals will be better situated to make the most economically appropriate decisions regarding purchasing health care. Without the mandate penalty, many individuals may decide to purchase less generous insurance (regardless of actuarial value) if it is better suited to their needs and lifestyle. This change will allow individuals to purchase less-expensive insurance and to have more personal control over their resources.

We might expect to see higher wages in the states impacted by *King*, even among employers that do offer insurance to their employees, because they will be able to make employment decisions and run their businesses more efficiently. AAF estimates that the ACA's regulations have reduced annual wages for employees of small and medium sized businesses by $830 to $940 each, totaling $13.6 Billion in the *King* states. There will be fewer administrative burdens when employers offer full-time employment to qualified employees who will have the opportunity to become specialized and therefore more efficient in their work. We might also expect to see more job growth in these states as employers expand their businesses and offer more hours without the cost of complying with the ACA.

Insurers may also begin adapting their plan designs to better meet the physical and financial needs of citizens of these states. These plans will still be subject to the many restrictions on plan design imposed by the ACA, but the restrictions on what types of plans

individuals may purchase will be lifted. For example, an individual over the age of 30 would be able to purchase catastrophic health insurance without being subject to the individual mandate penalty if standard policies are not affordable to them. Community rating and other Essential Health Benefit requirements would, however, remain in effect absent further legislative action.

CONCLUSION

While a ruling in favor of the plaintiff in the *King v. Burwell* case would prohibit subsidies flowing to states without their own exchanges, there are also economic benefits related to the elimination of the individual mandate for some and the employer mandate for all affected citizens. Almost 11.1 million individuals will become eligible for an exemption from the individual mandate penalty, and 1.27 million will be incentivized to re-enter the labor market. Millions of employers will also be released from the employer mandate penalty, which could lead to wage increases of up to $940 per employee, and would eliminate employment restrictions that have left 3.3 million part-time workers unable to work more hours.

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[1] 6.6 million individuals were enrolled in the 37 *King* state exchanges as of March 31, 2015 (an earlier version of this paper estimated 7.7 million based on reports from February, 2015). This is not a static number as some individuals may not have paid their first premiums, or have left the exchange due to a new job or otherwise attaining access to employer sponsored coverage. Likewise, more individuals may enroll in the exchanges through the administration's enrollment period extension, or as a result of a qualifying life event, such as a move or change in family size.