

## Small Business Prescription for National Healthcare Reform: The Details

### Small business: The engine that drives our economy

America's 27 million small businesses are the engines of our economy, creating 79% of our net new jobs (100% of net new jobs in past recessions).<sup>1</sup> Affordable, accessible healthcare is the No. 1 problem facing small businesses in this country.<sup>2</sup> With the continuing loss of millions of jobs, small business is vital to pulling us out of the recession. We need to fix healthcare to ensure the success of small business.

### The problem

Small businesses are facing a crisis. Not only is the economy in a nosedive, but the relentless rise in the costs of providing health benefits has crippled small businesses. Furthermore, the complex and time-consuming task of administering health benefits is a major burden for small employers. As a result, small business owners are forced to reduce health benefits or eliminate them all together, further increasing the number of uninsured. We are on an unsustainable path.

**Problem #1 — Costs.** This is the most serious problem that most small businesses face in the current healthcare system. Small business health insurance premiums are increasingly unaffordable, having risen 113% over the last 9 years<sup>3</sup>—a growth rate of nearly 9% annually. If these trends continue, the rise in premiums is expected to make a bad situation even worse. The three elements of the cost challenge small businesses face are:

- **Basic costs:** The costs of the overall U.S. healthcare system are too high—16% of GDP—and increasing at too fast a pace—+6-7% annually<sup>4</sup>, or 2-3 times the rate of general inflation. This is the fundamental problem underlying the high and rapidly increasing health insurance premiums small businesses and their employees are struggling to pay.
- **Cost shift:** Providers who take care of uninsured patients—especially hospitals, which are legally required to provide emergency services to patients regardless of ability to pay—recover their losses by increasing their charges for commercially insured patients. These higher charges are passed along to employers and consumers through higher health insurance premiums. The result is an increase in the average commercial premium of 8%.<sup>5</sup> A similar problem results from the underpayment to providers to take care of Medicare and Medicaid patients. A recent study indicated that this could add as much as 10.6% to commercial premiums.<sup>6</sup> These problems are expected to get even worse as the number of uninsured rises due to the current economic recession and funding for Medicaid and Medicare is cut back due to government revenue shortfalls.

<sup>1</sup> Employer Firm Births and Deaths by Employment Size of Firm, 1989-2005, Small Business Administration Office of Advocacy

<sup>2</sup> "Study shows small business owners support health reform," Robert Wood Johnson Foundation, 2008.

<sup>3</sup> Kaiser Family Foundation/HRET Employer Health Benefits Annual Survey, 2008.

<sup>4</sup> Sisko et al, "Health spending projections through 2018: recession effects add uncertainty to the outlook," *Health Affairs*, March-April 2009.

<sup>5</sup> Families USA, "Paying a Premium: The Added Cost of Care for the Uninsured," June 2005, or Furnas, Ben and Peter Harbage, "The Cost Shift from the Uninsured," The Center for American Progress, March 2009.

<sup>6</sup> Will Fox, and John Pickering, "Hospital & Physician Cost Shift," Milliman, December 2008.

- **Small business extra premium:** The smallest businesses pay on average 18% more than very large employers for similar health benefit plans.<sup>7</sup> This is due to (1) higher selling and administrative costs for insurers in the small group segment, (2) the lack of purchasing power by small businesses, and (3) the lack of consumer choice to drive price competition among insurers. In addition, individual small businesses with a high proportion of older or, in some states, less healthy, employees are charged rates far above the average. Furthermore, under the current tax code, the self-employed (sole proprietors) are unable to deduct premiums as a business expense and are required to pay an additional 15.3 percent self-employment tax<sup>8</sup>—their payroll tax—on their healthcare costs.

The bottom line is that we are not getting adequate value for the money we’re spending on healthcare. The quality of care we receive is inconsistent, and our health outcomes lag behind that of most other industrialized countries.

**Problem #2 — Choice.** In many parts of the US, small employers and sole proprietors have very little choice in health plans. Health insurers usually don’t allow small employers to offer competing plans, due to concerns about adverse selection; as a result, the employer is forced to accept a one-size-fits-all plan for her/his employees. The fact that the employees of these small businesses don’t have the opportunity to choose the health plan that is best for them can make it difficult to hire the best people.

**Problem #3 — Convenience.** Small business owners are busy people, focused on making their business successful, and they don’t have time to search out and negotiate for the best health insurance coverage for their employees. The costs of health benefits are so high, however, and the rates and coverage details are so confusing, that small businesses are forced to spend enormous amounts of time exploring options and administering their health plans. Time is money, and this burden is a real economic cost to small businesses.

**Problem #4 — Coverage.** Less than 49% of very small businesses offer healthcare coverage.<sup>9</sup> Three quarters of those who don’t say that affordability is the biggest impediment; three quarters of those who do offer healthcare benefits say that it’s a real struggle to do so.<sup>10</sup> In addition, many employees of small business have low incomes, and frequently are unable to pay their share of premiums. Furthermore, in most states, insurers are allowed to deny coverage to individuals due to their health status. As a result, many sole proprietors, whose only option is the individual health insurance market, can’t get coverage at all due to preexisting medical conditions.

### How we should tackle this

We need a comprehensive approach; piecemeal solutions will not be sufficient to fix the current healthcare crisis. Specific initiatives should be based on these principles:

- Build on the existing **private healthcare delivery and insurance system** rather than replace it with a government-run program.
- Ensure that **healthy competition and realigned financial incentives**—not top-down cost controls or regulation—drive improvements and spur innovation in the system.
- Use a **shared responsibility approach** for improving the healthcare system among government, business, insurers, individuals and healthcare providers.
- Design a system that is **economically sustainable**.

<sup>7</sup> J. Gabel et al., Generosity and Adjusted Premiums in Job-Based Insurance: Hawaii Is Up, Wyoming Is Down, *Health Affairs*, May/June 2006.

<sup>8</sup> Gurley-Calvez, Tami (2006). *Health insurance deductibility and entrepreneurial survival*. Report to the U.S. Small Business Administration, Office of Advocacy, under contract no. SBAHQ-04-M-0536

<sup>9</sup> Kaiser Family Foundation/HRET Employer Health Benefits Annual Survey, 2008.

<sup>10</sup> Small Business Majority survey of New Mexico small business owners, 2008.

## What small business needs

**Initiatives that contain costs**, improve quality and increase value

- Why? We need to slow the growth of overall healthcare costs in order to make coverage affordable and to improve the competitiveness of small businesses. An ambitious but realistic target is to hold the annual increase in basic healthcare costs to CPI+2%, or approximately 5%. The key to cost containment is to create a marketplace where there is healthy competition among insurers, which would create incentives to lower costs by increasing price competition and reducing competition based on risk selection. Specific actions that are likely to have the most impact include:
  - Infrastructure—conducting comparative effectiveness research and setting IT standards for electronic health record systems and secure information exchange
  - Transparency and public reporting—gathering and publishing user-friendly data on the cost and quality of insurers and providers, which would help consumers make well-informed decisions
  - Provider payment reform—moving away from the fee-for-service payment system that rewards volume of service rather than outcomes
  - Value-based benefit design—designing new benefit structures that encourage the use of health screening and preventive services, provide incentives for the cost-effective management of chronic conditions, and introduce consumer cost-sharing for preference-sensitive services, while protecting people from catastrophic costs
  - Evidence-based best practices—using comparative effectiveness research to provide physicians with the information to make the appropriate diagnosis and treatment decisions in consultation with their patients
  - Malpractice reforms—for example, providing legal protection for providers who use evidence-based best practices
  - Reduction of waste, fraud and abuse

These initiatives would have to be pursued together; the whole is greater than the sum of the parts. If done right, they could reduce the rate of increase to a level closer to the general inflation rate.

**Note:** Government policy can help “bend the cost curve,” but substantial progress will depend on shared responsibility among all stakeholders as well as concrete actions by private group purchasers, consumers and insurers. Government can take the lead on many important initiatives, such as infrastructure development, transparency, insurance reform and changes in the tax treatment of health benefits. It can also act in its role as purchaser for Medicare and Medicaid patients by using value-based benefit designs, pushing for provider payment reform and insisting on the use of evidence-based best practices. Employers, however, also need to strengthen their purchasing practices, ideally in a way that is consistent with Medicare and Medicaid, and consumers must adopt healthier behaviors and become more informed purchasers.

**Tax equity for self-employed**—Allow the self-employed to fully deduct their health insurance premiums for the purposes of their income tax and self-employment tax.

- Why? To provide self-employed small business owners with the same tax treatment that big businesses already have. This is money that could be used to reinvest and grow their business, or cover out-of-pocket expenses of their current health coverage. The self-employed are the only segment of the business population that pays this extra tax on health insurance. This is a serious financial burden on the country’s 20 million self-employed, including two million family farmers and ranchers.

### **Insurance reforms, including**

- Guaranteed availability of coverage (no medical screening)
- A prohibition on the exclusion of coverage for preexisting conditions
- Health insurance rating rules that prohibit adjustments for health status
  - Why? To remove barriers to coverage for people with serious health conditions, and to remove the penalty placed on business owners who hire people with serious health conditions. The reforms would also help lower overall cost trends by encouraging healthy price competition among insurers and reducing the use of risk selection tactics to control costs.

**A requirement that everyone have health insurance for a minimum defined set of health benefits**—with the provision that financial assistance be offered to those who can't afford the high cost of coverage

- Why? To allow rates to be set based on the collective cost of covering everyone, not just those whose healthcare is more expensive. Individual healthcare mandates are designed to eliminate the “freeloading” by young healthy people who don't purchase insurance, thereby increasing rates for everyone else and taxing the system unnecessarily when they get sick and need health facilities. However, without government subsidies and cost controls, individual mandates are doomed to fail—being required to have health insurance is a far cry from being able to afford it.
- If everyone has coverage, it will reduce the cost shift to employers, their employees, and the self-employed. To make sure the savings are passed along to employers and consumers, however, providers will need to reduce their charges for commercially insured patients, and insurers will need to pass on the savings in the form of reduced insurance premiums.
- A defined set of benefits is necessary to ensure consistency in the requirements for individuals to have coverage and potentially for employers to offer it. In addition, this would encourage healthy competition among insurers by helping consumers easily compare the cost, quality and service of health plan options.

**A health insurance connector or exchange**—a managed marketplace in which individuals and employees of small businesses can choose from among a variety of health plans. One feature of a connector should be an “online shopping mall” for health insurance, similar to what currently exists for travel reservations and mortgage loans.

- Why? A connector would pool small business buying power, reduce or eliminate the 18% extra premium paid by small businesses, and reduce the volatility (year-to-year changes) in health premiums. It would also offer health plan choices to employees, and—by allowing portability of health coverage—remove recruitment barriers. In addition, a connector would relieve small business owners of the burden of administering health benefits. And the resulting healthy competition among both insurers and providers would drive innovation and improvements in affordability, quality and customer service.
- Healthy competition: Some have proposed a public insurance plan option within the health insurance connector or exchange. Our research shows clearly that small business owners want the choice of a public insurance plan option to ensure healthy competition in the marketplace. Many studies have documented the lack of insurance policy options and healthy competition in many small state and rural markets. Still, cost containment, overall affordability and access to high-quality care are the top priorities for small business. To meet these objectives and encourage healthy competition, any public insurance plan should be on a level playing field,

with no special advantages over private plans, and it should deliver clear value to small businesses.<sup>11</sup>

**Financing based on the principle of shared responsibility**—including strong incentives and support for employers to offer affordable, high-quality health insurance. If the final legislation does involve a requirement that employers provide insurance or pay a fee, it must include some or all of the following provisions: a tax credit to help small businesses that couldn't otherwise afford to offer coverage, a phase-in period for startup companies, a sliding scale based on payroll or number of employees and an exemption for the smallest businesses.

- Why? To improve access to coverage for employees who currently can't afford the premiums. It would also put all businesses on a level playing field. Shared responsibility would ensure that everyone contributes equitably and eliminate the competitive disadvantage for businesses that do provide health insurance. If shared responsibility is not part of the solution, it is very likely that there will be a migration to individual (non-employment based) coverage, which will be subsidized by public funds even more than would be necessary otherwise. From this perspective, the choice is between shared responsibility—which strengthens the employer-based healthcare system—and a system in which the employers' contribution is replaced by publicly funded subsidies and additional taxes.
- A tax credit, phase-in period, sliding scale or exemption for the very smallest businesses would align the cost of health coverage with the small businesses' ability to pay. Most startups and many growing small businesses are not profitable and struggle with the high cost of health benefits. It would be unrealistic to expect these businesses to absorb the full costs of providing these benefits. America needs small business to succeed and keep generating new jobs.

### The bottom line for small business

A well-designed comprehensive reform plan will have positive outcomes for small businesses. More importantly, the *failure* of current reform efforts would have devastating effects, as costs continue to rise and coverage becomes even less affordable. What will a successful reform plan achieve?

#### Cost containment

- Health premiums will be reduced by 18-36% (or up to 50% for the self-employed).
  - Using a health insurance connector or exchange will reduce or eliminate the 18% small business extra premium.
  - Providing coverage for everyone will reduce or eliminate the cost shift due to charity care for the uninsured (8% of commercial premiums), and increasing payments to providers who care for Medicaid and Medicare patients will reduce this component of the cost shift (as much as 10.6% of commercial premiums)—assuming that providers and insurers pass the savings on to employers and individuals in the form of reduced insurance premiums.
  - Allowing the self-employed to fully deduct their health insurance premiums for the purposes of their payroll tax will reduce the effective tax placed on health insurance costs by an additional 15.3%.
- The annual rate of increase in health premiums will be slowed from an average of 9% to 5%,<sup>12</sup> resulting in enormous cumulative savings over the next 10 years.

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<sup>11</sup> Len Nichols and John M. Bertko, "A Modest Proposal for a Competing Public Health Plan," New America Foundation, March 2009.

<sup>12</sup> The Commonwealth Fund Commission on a High Performance Health System, The Path to a High Performance U.S. Health System: A 2020 Vision and the Policies to Pave the Way, The Commonwealth Fund, February 2009.

- Prohibiting medical screening for health conditions and exclusion of coverage for preexisting conditions will force insurers to compete based on efficiency and value rather than risk selection.
- Encouraging consumer choice through a health insurance connector or exchange will result in healthy competition among both insurers and providers, that will, in turn, drive innovation and improvements in affordability, quality and customer service.
- The volatility of health insurance premiums will be reduced.
  - Pooling risk in a health insurance connector or exchange will make year-to-year changes more stable and predictable.

### **Choice**

- Small business owners and their employees will have a much broader choice of health plans, improving portability and reducing barriers to recruitment.
  - Using a health insurance connector or exchange will give employees access to a wide variety of health plans.

### **Convenience**

- Small business owners will have more time to spend on running their business.
  - Using a health insurance connector or exchange will free small businesses of most of the functions of administering health benefits, which will be assumed by the exchange.

### **Coverage**

- Small businesses and their employees, as well as self-employed people, will have affordable coverage.
  - Prohibiting medical screening for health conditions and exclusion of coverage for preexisting conditions will ensure that employees and sole proprietors are not denied coverage for serious health conditions.
  - Providing financial assistance to people who can't afford health insurance will enable everyone to have coverage.
  - Providing tax credits to small businesses will enable more small business owners to offer coverage to their employees.