



Testimony Submitted for the Record

on

**HEALTH CARE REFORM IN A STRUGGLING ECONOMY:
What is on the Horizon for Small Business?**

by

Terry Neese

Distinguished Fellow

National Center for Policy Analysis

**Committee on Small Business
United States House of Representatives
February 4, 2009**

Madam Chairwoman and members of the committee, I offer these comments for your consideration as you debate solutions to the difficulties faced by small businesses to provide health insurance. I hope you will consider my testimony in the context of improving and reforming the nation's health care system. I represent the National Center for Policy Analysis, a nonprofit, nonpartisan public policy research organization dedicated to developing and promoting private alternatives to government regulation and control, solving problems by relying on the strength of the competitive, entrepreneurial private sector.

This Committee knows better than most that small business employees are much less likely to have access to employer-sponsored health coverage than the employees of larger firms. According to the Kaiser Family Foundation:

- Of the 45.7 million people without health insurance, 20 million are employees — or in the families of employees — of businesses with 50 or fewer employees.¹
- Among companies with more than 50 employees, 95.6 percent of workers have health insurance, compared to 42.6 percent of individuals working for small businesses.²

Undoubtedly there are many reasons why small businesses are less apt to offer health coverage to their workers than larger firms. However, one issue the Committee should carefully examine is the host of costly regulations and mandated benefit laws that small businesses face. Larger employers that self-insure do not face these same barriers.

Small Businesses Face Higher Costs. Since 1999, the cost of employer-provided health insurance has risen 120 percent, or four times faster than prices generally, according to the 2008 Kaiser Family Foundation Employee Health Benefits Survey.³ Small businesses face higher-than-average costs:

- Insurance premiums for small businesses are 18 percent greater than those paid by large companies, estimates the Commonwealth Fund.⁴
- Administrative costs account for up to 25 percent of the cost of premiums for some small business health plans, compared to 10 percent for large firms.⁵

¹ Agency for Healthcare Research and Quality, Center for Cost and Financing Studies. "2006 [Medical Expenditure Panel Survey](#) - Insurance Component."

² Kaiser Family Foundation. "Kaiser/HRET Survey: 2007 Employer Health Benefits Survey." September 2007.

³ Kaiser Family Foundation. "Kaiser/HRET Survey: 2007 Employer Health Benefits Survey." September 2007.

⁴ Jon Gabel, M.A., Roland McDevitt, Ph.D., Laura Gandolfo et al. "Benefits and Premiums in Job-Based Insurance." Commonwealth Fund May 9, 2006.

⁵ U.S. General Accounting Office, Private Health Insurance; Small Employers Continue to Face Challenges in Providing Coverage, GAO 02-8, p. 14.

The problems faced by small businesses are exacerbated by continuing medical costs inflation. Health care costs are expected to rise 10 percent in 2009, according to the consulting firm Pricewaterhouse Coopers.⁶

Why Costs Are Higher for Small Businesses. One reason costs are higher for small group insurance is because states require small-group health policies to cover certain conditions, treatments and providers, whereas large employers often self-insure. Self-insured plans are governed by federal law rather than state regulations. The federal government has fewer benefit mandates. Small group premiums vary widely by state, and the highest premiums are in the most heavily regulated states.

According to the Council on Affordable Health Insurance, there are more than 1,961 state-mandated benefits that insurance companies are required to offer in their health plans, adding to the cost of small group health insurance.

- Mental health parity is one of the most expensive and pervasive mandates — 47 states require insurers to cover mental health conditions, adding 3 percent to 5 percent to premiums, according to CAHI estimates.
- Forty-six states require coverage for chiropractors, 11 states mandate acupuncturists and four require massage therapists.
- Four states require coverage of naturopaths, who utilize food and herbal remedies to complement (and sometimes in place of) surgery or drugs.

In Massachusetts, the Division of Health Care Finance and Policy reported that 13 cents of every dollar spent on health care goes to cover mandated benefits. CAHI estimates that these mandates add 20 to 50 percent more to the cost of insurance, depending on the state.⁷

Why Costs Are Lower for Large Employers. The Employee Retirement Income Security Act of 1974 (ERISA) exempts self-funded employer plans from state regulations. In self-funded plans, the firm pays employees' medical bills and a third party processes claims. Due to ERISA, large employers (and trade unions) do not face costly state mandates. Small businesses are at a distinct disadvantage compared to large companies because they purchase state-regulated coverage. In firms with 5,000 or more employees, 89 percent of workers were covered by self-insured arrangements in 2006, up from 62 percent in 1999, reports the Kaiser Family Foundation.⁸

⁶ PricewaterhouseCoopers' Health Research Institute. "Behind the Numbers: Medical Cost Trends for 2009." June 2008.

⁷ "Health Insurance Mandates in the States, 2008," Council for Affordable Health Insurance. May 2008.

⁸ Kaiser Family Foundation. "Kaiser/HRET Survey: 2006 Employer Health Benefits Survey." September 2006.

Solution: Let Businesses Band Together to Purchase Health Insurance. There are some 16,000 associations in the United States, and six million people are already insured through such organizations as the National Association for the Self-Employed.⁹ Association health plans (AHP) allow small business owners to pool resources, negotiate with insurers and purchase insurance plans for members. However, the existence of 50 sets of state regulations is a barrier to low-cost AHP health insurance, according to NCPA Senior Fellow Donald Westerfield. If small firms could buy AHP insurance with uniform federal regulations, they could enjoy the same lower administrative costs and greater bargaining power as large firms.

A Congressional Budget Office analysis found that AHPs would save 5 percent by avoiding state benefit mandates, and would reduce premiums 13 percent if the associations could purchase insurance across state lines.

Solution: Let Businesses Purchase Health Insurance from Insurers in Other States. Protection from interstate competition allows politicians to impose expensive mandates and costly regulations. Allowing businesses to purchase coverage across state lines would create more competitive insurance markets. Interstate competition would give more people access to affordable insurance. Steve Parente and Roger Feldman of the University of Minnesota found that purchasing across state lines would insure 12 million previously uninsured people.¹⁰

Solution: Let Businesses Contribute to the Cost of Employee-Owned Insurance. Health insurance in the United States is largely tied to employment because employer contributions for health insurance are tax deductible business expenses and do not count as taxable income for employees. Premiums for employer-paid health benefits avoid all income taxes and the payroll tax. By contrast, employees of small businesses without employer-provided health benefits get no tax relief.

Employers should be able to contribute to the cost of health policies purchased by their employees. Thus employees would get portability (a characteristic of individual insurance), but at premiums closer to the cost of group insurance. As a result, insurance coverage would follow people from job to job and workers would not face a disruption in benefits when their employment changes.

Furthermore, as the recent economic downturn has underscored, the average unemployment benefit of \$1,200 is hardly adequate to cover the average COBRA health insurance payment of \$1,069. And COBRA benefits are largely temporary. Individually-owned, portable health

⁹ Donald Westerfield. "Insuring the Uninsured through Association Health Plans." National Center for Policy Analysis. April 2003.

¹⁰ Stephen T. Parente, Ph.D., Roger Feldman, Ph.D., Jean Abraham, Ph.D., and Yi Xu, B.A., "Consumer Response to a National Marketplace for Individual Insurance," University of Minnesota, June 28, 2008.

insurance would follow workers when they change jobs, even if they are unemployed for a time in between.

Conclusion. People should be able to purchase, with pretax dollars, health plans that are portable from one job to the next, just as group plans do. Employers should be able to help pay the premiums on those individual plans. To avoid costly state mandates, small businesses should be allowed to purchase plans similar to self-funded companies for their employees. If sections of ERISA are rewritten or association health plans allowed, small businesses could create a national marketplace where insurance companies and care providers compete for individuals on price and quality.

Thank you for your consideration of my remarks. As the Committee debates these and other small business issues in the future, I am happy to offer any assistance, insight, or advice that you find helpful.