

## Health Care for Small Businesses – An American Crisis

Today's small business owners report that their single biggest concern is the rising cost of health care coverage.

They have good reason to be concerned.

The current system of health care coverage is a threadbare patchwork of state, federal, private and individual initiatives with costs that are too high for small business owners. First, insurance premiums have increased fivefold for employers since 2000<sup>1</sup> and the trend promises to continue.<sup>2</sup> On top of that, the opportunity costs involved in researching and negotiating the maze of insurance options, government subsidies and tax breaks siphon human capital from innovation and entrepreneurship to the search for health care coverage.<sup>3</sup>

Faced with the chaos of the current system, small businesses are left with an unappealing choice: pay the overblown and disproportionate costs in purchasing and administering a health care plan<sup>4</sup> or, worse, offer no health care plan at all and suffer the competitive disadvantage in attracting and retaining talented labor.<sup>5</sup> These are the facts:

- More than 25 million workers of small businesses are uninsured.<sup>6</sup>
- Small businesses have reported increases in health care premiums as high as 70 percent in one year.<sup>7</sup>
- Two-thirds of employees would forego a \$10,000 increase in pay if it required losing their employer-based health insurance.<sup>8</sup>
- Only 43% of businesses with less than 50 employees are able to offer health insurance to their employees,<sup>9</sup> although two-thirds of small business employers say they would seriously consider offering health benefits if they received some assistance with the cost of premiums.<sup>10</sup>
- Over half of the uninsured in America work full time;<sup>11</sup> fully 70% of those work in very small businesses of less than 10 employees.<sup>12</sup>
- It is three times more likely that a small business employee is uninsured than a worker in a large firm.<sup>13</sup>

Despite years of rhetoric, our federal government has responded to the lobbying efforts of the insurance and pharmaceutical industries with tax breaks and reduced regulation, all the while failing to address our nation's health care crisis and its devastating effect on small business. Small Business Majority supports workable solutions that enable entrepreneurs to better manage the costs of providing health insurance to their employees.

It is time to reward America's entrepreneurs by leveling the playing field through fair policies and constructive public-private partnerships. SBM offers a three-point-plan to achieve these goals:

1. Comprehensive national health care reform.
2. National health insurance pools for risk sharing and purchasing power aggregation.
3. Health care tax equality for small businesses.

## **Comprehensive National Health Care Reform**

Comprehensive national health care reform is necessary to resolve the health care crisis facing America's entrepreneurs. The employer-based health insurance system in the United States contrasts sharply with government-supported health care systems of other industrialized countries and many developing countries and places a large burden on new and small businesses of covering their employees' health insurance needs. As is recognized by nearly all of America's business competitors in the developed world, health care solutions require a government partnership with individuals and businesses. Until Americans have access to affordable health care coverage, and the burden of health insurance costs has been lifted from employers and instead shared among private, public and individual participants, small business will remain at an economic disadvantage.<sup>14</sup>

The federal government continues to resist the inevitability of comprehensive reform through willful paralysis and continued piecemeal solutions. Despite inaction on the federal level, many states have taken it upon themselves to address our health care crisis, including its disproportionate effect on small business. Some of the state proposals are positive, and some are less than perfect results of very understandable frustration. None of them are substitutes for a national solution, but we can admire the political will that underlies them and we can learn from them. The most notable development (though certainly not perfect) is Massachusetts' recent passage of bi-partisan comprehensive health care reform that combines insurance pooling, individual mandates, employer mandates, government subsidies and cost containment measures. Its comprehensiveness is the result of what will be needed at the national level: a realization by all interest groups -- business owners, employees, the health care community and government -- that the only possible solution is one where everyone steps up and contributes.

Small Business Majority (SBM) stands ready to work in collaboration with others to draft and support comprehensive health care reform legislation that ensures the availability of affordable health care coverage for all Americans and removes the anti-competitive burden of health care costs currently faced by America's entrepreneurs.

## **National Small Business Health Insurance Pools**

In the absence of comprehensive national health care reform, there are steps that we can take to address the health care crisis facing small businesses.

Any viable health care reform must include a "pooling" component, in which individual participants aggregate purchasing power, and spread risk among the larger group. This is a key component of the Massachusetts legislation. Aggregated purchasing power results in increased negotiating leverage with Insurers and "volume discounts" that the individual small business owner could not obtain on his or her own. Spreading risk allows employers with a few chronically ill employees to dilute that risk among the diversified group, thereby keeping premiums down.

SBM endorses the Small Employers Health Benefits Program Act of 2006 (SEHBP) – S. 2383 – proposed by Sen. Blanche Lincoln (D-AR) and Sen. Richard Durbin (D-IL) and co-sponsored by 22 other U.S. Senators.<sup>15</sup> The SEHBP would allow small business owners to offer health insurance through a federal program modeled after the Federal Employees Health Benefits Program (FEHBP), the health insurance plan used by the Federal Government to offer health care coverage to all its employees, from postal workers to Senators. The new plan would be managed by the Office of Personnel Management (OPM), which already successfully manages the FEHBP.

Under SEHBP, small businesses of 100 employees or less (with certain exceptions) will pool both risk and purchasing power. By leveraging their aggregated purchasing power and spreading risk among all the plan's participants, small businesses could expand their access to affordable health insurance for their employees. The benefits of the SEHBP are significant:

- **Less administration for employers; more choices for employees**

Under the current health care system, those small business owners who *are* able to offer health insurance have to spend their time and energy seeking out, reviewing, negotiating and administering health insurance programs on behalf of their employees, only to be able to offer a one-size-fits all plan, with no alternatives. Under the SEHBP, small business owners would be relieved of the burdensome negotiation process. Instead, small business employees could choose the best-suited plan from a list negotiated and compiled by OPM setting forth all national insurance programs, state insurance programs set forth state-by-state, and Health Savings Accounts.

- **Subsidies to reduce the burden of premiums**

Under SEHBP, small business employers paying at least 60% of low-wage employees' health insurance premiums would receive a subsidy in the form of a federal tax credit, to be granted regardless of the business' year-end tax bill. The refund would cover a quarter of the cost of the small business owner's premiums for single employee coverage and 35% of family coverage premiums. As the employer takes on an increased share of benefit coverage, the subsidy would increase.

- **Continued insurer accountability**

State agencies currently regulate the insurers doing business in their state: this state regulation is a vital component in managing the cost of health insurance by maintaining high solvency standards and preventing fraud, among other things. Under SEHBP, states would continue to regulate the insurance industry, something missing in many of legislative alternatives.

This bill (and its companion legislation as introduced in the House by Rep. Ron Kind<sup>16</sup>) has been endorsed by the American Medical Association and many other national medical groups. SBM was the first business group to endorse SEHBP, and SBM intends to continue to play a significant role in moving this proposal forward.

SBM also endorses the creation of not-for-profit healthcare purchasing cooperatives for self-insured employers with less than 99 employees who purchase health insurance for their employees through the Promoting Healthcare Purchasing Cooperatives Act of 2005.<sup>17</sup> This proposal includes important educational initiatives.

## **Health Care Tax Equality for Small Businesses**

### ***Health Care Tax Reform***

The current tax code treats big business' employee health care costs as a deductible business expense, but for certain small businesses, health care costs are treated as merely another form of taxable compensation. As many freelancers know all too well, the self-employment tax (FICA) is calculated before the cost of healthcare premiums is deducted. With the self-employment tax rate at 15.3%, this can result in a significant burden (For example: a person paying \$5,000 a year in premiums pays \$765 extra for that insurance through taxes). SBM endorses the Equity for Our Nation's Self-employed Act of 2005 sponsored by Sen. Jeff Bingaman (D-NM), an amendment to

the Internal Revenue Code to allow self-employed individuals to deduct health insurance costs when computing self-employment taxes and close the loophole that discriminates against small business owners of non-corporate entities.<sup>18</sup>

### ***Tax Credits for Small Business Employers***

As in the case of the SEHBP (already discussed), SBM supports the idea of tax credits as a federal subsidy designed to help small businesses afford employees' health care coverage. In this spirit, SBM has endorsed:

- The Access to Affordable Health Care Act, sponsored by Sen. Susan Collins (R-ME) and Sen. Mary Landrieu (D-LA),<sup>19</sup> which amends the tax code to provide tax credits to small businesses for qualified employee health insurance expenses and encourages health coverage innovations.
- The Small Business Health Insurance Expansion Act of 2005, sponsored by Rep. Dennis Moore (D-KS), a bill amending the tax code that would assist small business owners with less than 50 employees to pay for employees' health care coverage.<sup>20</sup>
- The Keeping Small Businesses Healthy Act of 2005, sponsored by Rep. Darlene Hooley (D-OR) amends the tax code to grant certain small business employers with less than 101 employees a refundable tax credit for up to 60% of employees' health insurance costs.<sup>21</sup>

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### **Stand-Alone Solutions: Unfair, Insufficient and Unreliable**

SBM is skeptical of piecemeal solutions to the current health care crisis. Any single mechanism will inevitably fall short of providing affordable and effective solutions to small business owners' current health care crisis, regardless of its political origins. Four current alternatives – Individual Mandates, Employer Mandates, Association Health Plans (and the related Small Business Health Plans), Health Savings Accounts and– have each been offered as a silver bullet, but each, on its own, ultimately fails to provide comprehensive, fiscally sound, affordable and reliable options that meet the health care needs of small business owners and their employees.

#### ***Both Individual Mandates and Business Mandates Must be Part of a Larger Solution that Includes Government Partnership, cost controls and pooling.***

When part of a larger solution that includes pooling, cost controls and government subsidies, mandates offer useful tools in building comprehensive reform. But, on their own, mandates simply won't work. Health care insurance mandates require the individual or the employer to obtain coverage or suffer some penalty. Both individual mandates (making the individual responsible for his or her insurance coverage) and business mandates (leaving the responsibility for employee coverage on the employer) can advance the goal of universal health coverage. But, they will fail to provide relevant reform,<sup>22</sup> *unless* coupled with comprehensive government involvement and supplemented by truly affordable options.

*Individual Mandates.* Individual health care mandates are designed to eliminate the “freeloading” by young healthy people who don't purchase insurance, thereby increasing rates for everybody else and taxing the system unnecessarily when they get sick and have to use public 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.<sup>23</sup> When combined with government subsidies, we see how individual mandates can fit into comprehensive reform. In Massachusetts, for example, individuals are required to obtain health insurance coverage; those who cannot afford it receive government assistance based on a sliding scale.

*Business Mandates.* Employer mandates are designed to eliminate business “freeloaders,” whose employees are forced to use public health services, resulting in higher costs and a competitive disadvantage for businesses that do provide health insurance. Having said that, a stand-alone employer mandate does not alleviate disproportionate financial burdens and opportunity costs. Instead, it leaves small businesses exposed to higher costs if they have unhealthy workers.<sup>24</sup> Business mandates can work well, however, when combined with individual mandates, pooling, cost controls and government participation. While the business penalties for non-provision of coverage have been the source of much debate in Massachusetts, the reasoning is sound: after factoring in statewide coverage rates, small businesses that opt not to participate are required contribute their share of the costs that will inevitably result when their employees turn to the state system.<sup>25</sup> Small businesses are prepared to pay their fare share: nothing less, nothing more.

### ***Association Health Plans and Small Business Health Plans Have Been Tried – and Failed.***

America has already endured the failure of the association health plan model in the 1970s and 1980s, when multiple employer welfare arrangements (MEWAs) left gaping holes in government regulation. The resulting health insurance scams left hundreds of thousands of people saddled with billions of dollars of unpaid medical bills.<sup>26</sup> Both Association Health Plan (AHPs), introduced by Rep. Sam Johnson (R-TX) and Sen. Olympia Snowe (R-ME),<sup>27</sup> and the related Small Business Health Plans (SBHPs) (which mimic the structure of AHPs and retain many of the AHPs’ shortcomings), introduced by Sen. Mike Enzi (R-WY),<sup>28</sup> risk repeating the mistakes of the past. SBM has joined many national business and medical groups in active opposition to both of these initiatives and will continue to resist AHPs or SBHPs in their future incarnations.

Under AHPs, professional associations pool both risk and expense for its participating members, but without the state regulation that enforces fair business practices (including rights of appeal and mandating certain benefits), keeps premium increases at a reasonable level, and ensures solvency of the insurer. Most significantly, AHPs do not reduce the cost of health insurance coverage, which is the greatest barrier to a small business’s ability to provide health care.

While SBHPs skirt some of the problems of AHPs, including the dangers posed by unregulated self-insured plans, they are also flawed. Like AHPs, SBHPs lower the bar for insurers to so that only those benefits mandated by 45 states must be provided by the SBHP (preempting many important benefits mandated by most states, including maternity and mental health benefits). Next, without state regulation, they offer minimal safeguards against cost inflation for vulnerable workers as insurers raise rates without penalty. Finally, they fail to help lower-income workers afford coverage in the first place, ignoring the threat of adverse selection.<sup>29</sup> If SBHPs take root as “the” solution for small business insurance coverage, small businesses will be burdened with skyrocketing costs – just another healthcare burden that could hinder their ability to grow or provide benefits at all. New Hampshire experimented with this formula and ultimately suffered as a result. Their experience provides an object lesson: In a letter to State Senator Judd Gregg on the current SBHP proposals, New Hampshire Governor John Lynch recounted how, when insurers could discriminate against sick or geographically unappealing workers, small business health insurance costs skyrocketed, limiting their ability to expand, hire or even continue to offer coverage.<sup>30</sup>

### ***HSAs can be Useful Supplements, but are Far From a Comprehensive Solution, and are Too Expensive***

Despite the claims made in the January 2006 Presidential State of the Union Address, with a 10-year price tag that may be as high as \$156 billion<sup>31</sup> (more than double the proposed cuts in Medicare spending),<sup>32</sup> Health Savings Accounts (HSAs) are insufficient to provide relief for the crushing cost of health care faced by small business people. HSAs are tax-free savings accounts for ordinary medical expenses that are coupled with high-deductible insurance policies for major

medical emergencies. At best, HSAs represent a useful alternative only for healthy or wealthy employees. They should be considered a supplement and not a stand-alone solution to the problem.

As a stand-alone solution to the health care crisis, HSAs fail both workers and small business. First, under HSAs, employees are still almost entirely responsible for their own health care costs, and thus are drawn to more holistic coverage offered by big business. Next, HSA participants have the limited coverage of high-deductible health plans that do not cover emergency care or catastrophic illness. Insurance companies would still be responsible for the cost of catastrophic illness, a major cost driver behind skyrocketing premiums.

Most importantly, HSAs would result in “adverse selection” and a resulting explosion in the cost of coverage. As healthy employees take advantage of these savings accounts and wealthy Americans use them to shelter income, older workers and the chronically sick will remain dependent on more traditional coverage plans. As a result, traditional plans, already an oversized burden on small business, would become impossible to afford and leave small business at a worse competitive disadvantage than they find themselves in today.<sup>33</sup>

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## Resources

*Employer Health Benefits Survey: 2005*

The Henry J. Kaiser Family Foundation, September 14, 2005

Available online at: <http://www.americanprogress.org/site/pp.asp?c=biJRJ8OVF&b=477169>

*The President's Health Proposals: The Wrong Treatment for Our Health Care Crisis*

Center for American Progress, January 25, 2006

Available online at <http://www.americanprogress.org/site/pp.asp?c=biJRJ8OVF&b=1371605>

*Progressive Prescriptions for a Healthy America*

Center for American Progress, March 22, 2005

Available online at: <http://www.americanprogress.org/site/pp.asp?c=biJRJ8OVF&b=477169>

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<sup>1</sup> Henry J. Kaiser Family Foundation / Health Research and Education Trust, *Employer Health Benefits Survey: 2005* (Menlo Park, Calif: KFF/HRET, 14 September 2005).

<sup>2</sup> It comes as no surprise that health insurance premiums have outpaced inflation ever year since the late 1990s. Employee Benefit Research Institute, *2005 Employee Health Confidence Survey*. Available online at: [http://www.ebri.org/pdf/EBRI\\_IB\\_11-2005.pdf](http://www.ebri.org/pdf/EBRI_IB_11-2005.pdf).

<sup>3</sup> A recent report by the Employee Benefit Research Institute found that many Small business owners tweak their offerings each year: in 2002, 19 percent of small employers offering health benefits made changes to their health plan between 2001 and 2002. Sixty-five percent increased deductibles and co-pays; 35 percent switched insurers; 30 percent increased the employee share of the premium; and 29 percent cut back on the scope of benefits. Employee Benefit Research Institute, *Small Employers and Health Benefits: Findings from the 2002 Small Employer Health Benefits Survey*. Available online at: <http://www.ebri.org/pdf/briefspdf/0103ib.pdf>.

<sup>4</sup> Surveys show that Small Business Owners who do not currently do so *would* like to provide health coverage and would be willing to pay a portion of health care premiums. See Tom Daschle, “Paying More but Getting Less: Myths and the Global Case for U.S. Health Reform,” Center for American Progress, November 9, 2005.

<sup>5</sup> It is more difficult to keep turnover down and have a full-time workforce if a small business employer cannot offer health coverage. See footnote 3.

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<sup>6</sup> Henry J. Kaiser Family Foundation / Health Research and Educations Trust, *Employer Insurance Study*, 2003.

<sup>7</sup> U.S. Senate Committee on Small Business & Entrepreneurship, Democratic Staff, "Kerry Challenges Administration's Big Business Agenda," April 27, 2005.

<sup>8</sup> See footnote 2.

<sup>9</sup> Henry J. Kaiser Family Foundation, *State Health Facts*. Available online at: <http://www.statehealthfacts.org>

<sup>10</sup> See footnote 3.

<sup>11</sup> Employee Benefit Research Institute, *Estimates from the March Current Population Survey*, 2004 Supplement.

<sup>12</sup> Fronstin, Paul, "Sources of Health Insurance," EBRI Issue Brief No. 276, Figure 10, December 2004.

<sup>13</sup> U.S. Census Bureau, *Current Population Survey*, 2002.

<sup>14</sup> In addition to the oft-discussed social policy and justice reasons, there are solid business reasons for achieving a system of universal health care coverage. See footnote 4.

<sup>15</sup> "The Small Employers Health Benefits Program Act of 2006," 109<sup>th</sup> Congress, 2<sup>nd</sup> sess., S. 2382.

<sup>16</sup> "The Small Employers Health Benefits Program Act of 2005," 109<sup>th</sup> Congress, 1<sup>st</sup> sess., H.R. 1955.

<sup>17</sup> "The Promoting Healthcare Purchase Cooperative Act of 2005," 109<sup>th</sup> Congress, 1<sup>st</sup> sess., S. 820, cosponsored by Sen. Russell Feingold (D-WI) and Sen. Susan Collins (R-ME).

<sup>18</sup> "The Equity for our Nation's Self-Employed Act of 2005," 109<sup>th</sup> Congress, 1<sup>st</sup> sess., S. 663

<sup>19</sup> "The Affordable Health Care Act," 109<sup>th</sup> Congress, 1<sup>st</sup> sess., S. 16.

<sup>20</sup> "Small Business Health Insurance Expansion Act of 2005," 109<sup>th</sup> Congress, 1<sup>st</sup> sess., H.R. 2001, sponsored by Dennis Moore (D-KS).

<sup>21</sup> "Keeping Small Business Healthy Act of 2005" 109<sup>th</sup> Congress, 1<sup>st</sup> sess. H.R. 118.

<sup>22</sup> The risks of implementing such a plan include adverse selection, increased unemployment and increased cost in the private health insurance market. Anna D. Sinaiko, "Employers' Responses to a Play-Or-Pay Mandate: An Analysis Of California's Health Insurance Act Of 2003," *Health Affairs*, 13 October 2004. Available online at: <http://content.healthaffairs.org/cgi/content/full/hlthaff.w4.469/DC1>.

<sup>23</sup> Leif Wellington Haase, "The Problem with Individual Mandates," The Century Foundation, October 28, 2005.

<sup>24</sup> The concerns of just one small business facing an employer mandate under Massachusetts proposed changes are explored by Christopher Rowland in "Fearing Cost of a Health Mandate," *The Boston Globe*, November 17, 2005.

<sup>25</sup> David B. Kendall "Massachusetts Raises the Bar for Health Care Reform," Progressive Policy Institute, April 17, 2006. Available online at: [http://www.ppionline.org/ppi\\_ci.cfm?knlAreaID=111&subsecid=137&contentid=253823](http://www.ppionline.org/ppi_ci.cfm?knlAreaID=111&subsecid=137&contentid=253823)

<sup>26</sup> MEWAs had a shelf life of ten years. By 1982, Congress was holding hearings documenting the insurance scams by MEWA operators, including those offered by associations. Since then, Congress has had to engage in ongoing attempts to return regulation to the states.

<sup>27</sup> "The Small Business Health Fairness Act of 2005," 109<sup>th</sup> Congress, 1<sup>st</sup> sess., H.R. 525 (passed) and S. 406.

<sup>28</sup> "The Health Insurance Marketplace Modernization and Affordability Act of 2005," 109<sup>th</sup> Congress, 1<sup>st</sup> sess., S. 1955.

<sup>29</sup> The recent failure of very healthy and low-income workers to join a pilot program by 60 of the country's largest employers offering high deductible health plans to uninsured workers illustrates the problem: healthy workers opt out, and poor workers simply can't afford it. Vanessa Fuhrmans, "Few Uninsured Workers Opt for Employers' New Health Plans," *The Wall Street Journal*, February 8, 2006, page B1.

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<sup>30</sup> Available online at:

<http://www.nationalpartnership.org/portals/p3/library/TheUninsured/S1955/NHGovltrS1955.pdf>

<sup>31</sup> House Budget Committee, Democratic Staff, *Summary and Analysis of the President's Fiscal Year 2007 Budget*, February 6, 2006. Available online at: [http://www.house.gov/budget\\_democrats](http://www.house.gov/budget_democrats).

<sup>32</sup> Sarah Lueck, "Tax Breaks to Boost Cost of Bush's Health Care Budget," *Wall Street Journal*, February 6, 2006, p. A1.

<sup>33</sup> For an interesting discussion of recent proposals advocating large scale implementation of HSAs, see "The Lopsided Bush Health Plan," *The New York Times*, February 3, 2006.