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SENATE COMMITTEE ON SMALL BUSINESS

HEALTH CARE REFORM: THE CONCERNS AND PRIORITIES FROM THE PERSPECTIVE OF SMALL BUSINESS

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Madame Chair Landrieu, Ranking Member Snowe, Senator Wyden and other distinguished members of the Committee, thank you for inviting me to testify and participate in this roundtable discussion today. My name is Len M. Nichols. I am a health economist and I direct the Health Policy Program at the New America Foundation, a non-profit, non-partisan public policy research institute based in Washington, D.C., with offices in Sacramento, California. Our program seeks to nurture, advance, and protect an evidence-based conversation about comprehensive health care reform. We remain open minded about the means, but not the goals: all Americans should have access to high-quality, affordable health insurance and health care that is delivered within a politically and economically sustainable system. The best way, though not the only way, to accomplish these goals is to ensure reform legislation earns bipartisan support. I am happy to share ideas for your consideration today and hereafter with you, other members of the Committee, and staff.

GOAL OF REFORM

The technical goal of health insurance reform is to extend the advantages of large group purchasing – large, balanced risk pools and administrative economies of scale – to all.

To achieve this goal, several reforms are necessary:[i]

- A new insurance marketplace to pool risk and reduce administrative burden.
- New insurance market rules to make quality health coverage accessible to all.
- Minimum benefit package to ensure that coverage is meaningful.
- Subsidies to make certain quality coverage is affordable to all.
- Requirement to purchase coverage to balance the risk pool and make sure everyone is paying their fair share for health care.
- Increased emphasis on insurer transparency to engender fair competition and give consumers the information they need to make informed choices about the insurance products that are right for them.

Improving administrative economies of scale is particularly important for people currently enrolled in small group and individual policies. While verifiable data is difficult to obtain, credible analysts believe that the average administrative load of small group policies (the difference between premium revenue and claims costs) ranges between 20 and 30 percent. Our own New America calculations using Medical Expenditure Panel Survey (MEPS) Data suggest that administrative loads could be as a high as 45 percent for families purchasing non-group coverage. By comparison, the Federal Employees Health Benefits Plan (FEHBP) operates with administrative loads between 10 and 12 percent. Establishing this level of efficiency for all is one goal of a new marketplace or exchange. Reducing administrative loads by 15 to 30 percent would translate into significant savings for people currently enrolled in small group and individual policies.

ISSUES RELATED TO TRANSITION

Once we establish the ultimate goal of reform, we must identify a successful pathway. To do this, a few important issues should be examined.

How small is "small?"

Most reform proposals envision an insurance exchange available, at least initially, to individuals without access to health insurance through their employer and those who work for small businesses, whether they offer insurance now or not. Under most proposals, large groups (who mostly self-insure) would continue to purchase insurance on their own. But if the goal of reform is to extend the advantages of large group purchasing to all, how small should "small" be for the purposes of eligibility for the exchange?

I would submit the dividing line between small and large should be the firm size at which an employer can safely and efficiently self-insure. Actuarial experts tell me this is between 200 and 500 workers, not the typical 50 that defines the upper bound of the "small" group market in the vast majority of states (some go as low as 25). Cutting off exchange eligibility at 10, 25, or even 50 workers puts firms of 11, 26, and 51 at the mercy of what the commercial market currently offers them today. In most states, this is highly unsatisfactory. Lack of effective and transparent competition in many small group markets leads to high administrative loads, little choice, and the highest premium inflation of any market segment. With your leadership, we can do far better by our small employers.

From Underwriting to Modified Community Rating

The transition from heavily underwritten policies to policies priced via a modified community rate will impact different individuals differently in the short-run. In the long-run, all individuals should experience stable, fair premiums regardless of their health or employment status.

The short-run impact of moving from one market to another is particularly relevant when considering age rating. Moderate age rating allows young, healthy individuals who are often most reluctant to enroll in coverage to pay less than older, higher risk individuals. In addition, since low-income individuals are more likely to be young, age rating decreases the necessary aggregate subsidies that must be provided (and financed) because the policy being subsidized is less-expensive at the outset.

Today, however, small group policies for firms with fewer than 10 workers are rated based in part on the average age of the firm. For individual workers in firms where the average age is below their personal age, loose age rating bands in the exchange could result in higher premiums. Compared to pure community rating, a 2:1 rate band would lessen the cost for the young and healthy while still protecting older workers from the actuarial reality of their higher risk.

Subsidies

In general, a fair amount of research concludes that it is more efficient to subsidize workers directly, rather than through firms.[ii] This is because subsidizing employers without regard to income or wages will inevitably end up directing some portion of limited resources to firms with at least some higher wage workers. High-wage firms (e.g. law or consulting firms) would likely offer generous coverage without new employer subsidies because many of them are already offering today.

In a reform package that provides low-income subsidies directly to workers, such as those being discussed in Congress, subsidies directed at small firms could be one way to encourage more businesses to make contributions toward their workers' coverage and utilize the exchange. Subsidies or tax credits directed to firms might also mitigate any disruption or temporary "sticker shock" resulting from market transition to an age-rated insurance environment. Firms have every incentive to pass subsidies directly on to workers. Therefore, small business tax credits for the purchase of health insurance are effectively wage or benefit subsidies to the workers.

CONCLUSION

Small employers will always hold a large stake in conversations about health care reform because no single group is more important to the American economy and society. Small group insurance markets have been the focus of repeated policy interventions at the state and federal levels since the late 1980s. Health reform should make our health system sustainable for us all for the long-term. To be worth the name, however, near-term health reform must provide small businesses relief from the current dysfunctional small group insurance market.

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[i] For more information about these reforms see other Len M. Nichols testimony: http://www.newamerica.net/files/Nichols%20Senate%20Finance%205.5.09.pdf; http://www.newamerica.net/files/Microsoft%20Word%20-%20Nichols%20HELP%20testimony%20March%2009%20FINAL.pdf

[ii] Ferry, Danielle, Sherry Glied, Bowen Garrett, and Len M. Nichols, "Health Insurance Expansions of Working Families: A Comparison of Targeting Strategies," Health Affairs 21, no. 4 (July/August 2002).