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DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
001. memo	The Politics of the Employer Mandate (6 pages)	4/20/94	Personal Misfile

COLLECTION:
Clinton Presidential Records
Domestic Policy Council
Chris Jennings (Health Security Act)
OA/Box Number: 23754

FOLDER TITLE:
April 1994 HSA

gf117

RESTRICTION CODES

Presidential Records Act - [44 U.S.C. 2204(a)]

P1 National Security Classified Information [(a)(1) of the PRA]
P2 Relating to the appointment to Federal office [(a)(2) of the PRA]
P3 Release would violate a Federal statute [(a)(3) of the PRA]
P4 Release would disclose trade secrets or confidential commercial or financial information [(a)(4) of the PRA]
P5 Release would disclose confidential advise between the President and his advisors, or between such advisors [a)(5) of the PRA]
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b(3) Release would violate a Federal statute [(b)(3) of the FOIA]
b(4) Release would disclose trade secrets or confidential or financial information [(b)(4) of the FOIA]
b(6) Release would constitute a clearly unwarranted invasion of personal privacy [(b)(6) of the FOIA]
b(7) Release would disclose information compiled for law enforcement purposes [(b)(7) of the FOIA]
b(8) Release would disclose information concerning the regulation of financial institutions [(b)(8) of the FOIA]
b(9) Release would disclose geological or geophysical information concerning wells [(b)(9) of the FOIA]

Withdrawal/Redaction Marker
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Mitchell File

PROTECTING SMALL BUSINESSES

- **Changes to the Health Security Act can:**
  - **better target employer subsidies for low and moderate wage workers, and**
  - **achieve greater deficit reduction.**
- **Additional changes can assure greater affordability for small businesses, but result in less deficit reduction.**

THREE WAYS SUGGESTED TO PROTECT SMALL BUSINESSES MORE

- Provide greater subsidies to small businesses with fewer than 10 workers.

- Exempt small businesses under 10 workers from employer requirement.

- Lower the share of premium businesses must pay (e.g., from 80 % to 50 %).

PROTECTING SMALL BUSINESSES: POTENTIAL PROBLEMS

- Risk of firm size gaming.
- Administrative complexity for business, families, and government.
- Equity.
- Maintenance of current payments.
- Cliffs.
- Deficit reduction.

Health Security Act:

- Employer/Employee Share. **Before subsidies, employers pay 80% of average premium. Families are required to pay no more than 20% of average plan.**

- Employer/Individual Subsidies. **Subsidies may reduce premium payments. Firms under 5,000 pay no more than 7.9% of total payroll. Households pay no more than 3.9 % of income.**

- Small Business. **Small firms (under 75) receive additional subsidies, paying no more than 3.5% to 7.9% of total payroll, depending on firm size and average wage.**

- Large Firms. **Firms with more than 5,000 employees which are outside the alliance pay 1% of payroll assessment.**

MODEL ONE AS BASE FOR COMPARISON

- Caps employer subsidies at 12% of worker's individual wage. Firms under 75 capped on sliding scale from 12% to 5.5%. Cap level based on number of workers and average payroll.
- Caps individual payments at 3.9% of income.
- Reduces firm threshold for community rating from 5,000 to 1,000. Assesses all 1,000+ firms 1% of payroll. All firms eligible for employer subsidies.

Average employer premium payment per family..$2,200

For smallest lowest-wage firms

Average employer premium payment per worker....................$700

Required employer premium payment per worker..................$600

Average family premium payment..$600

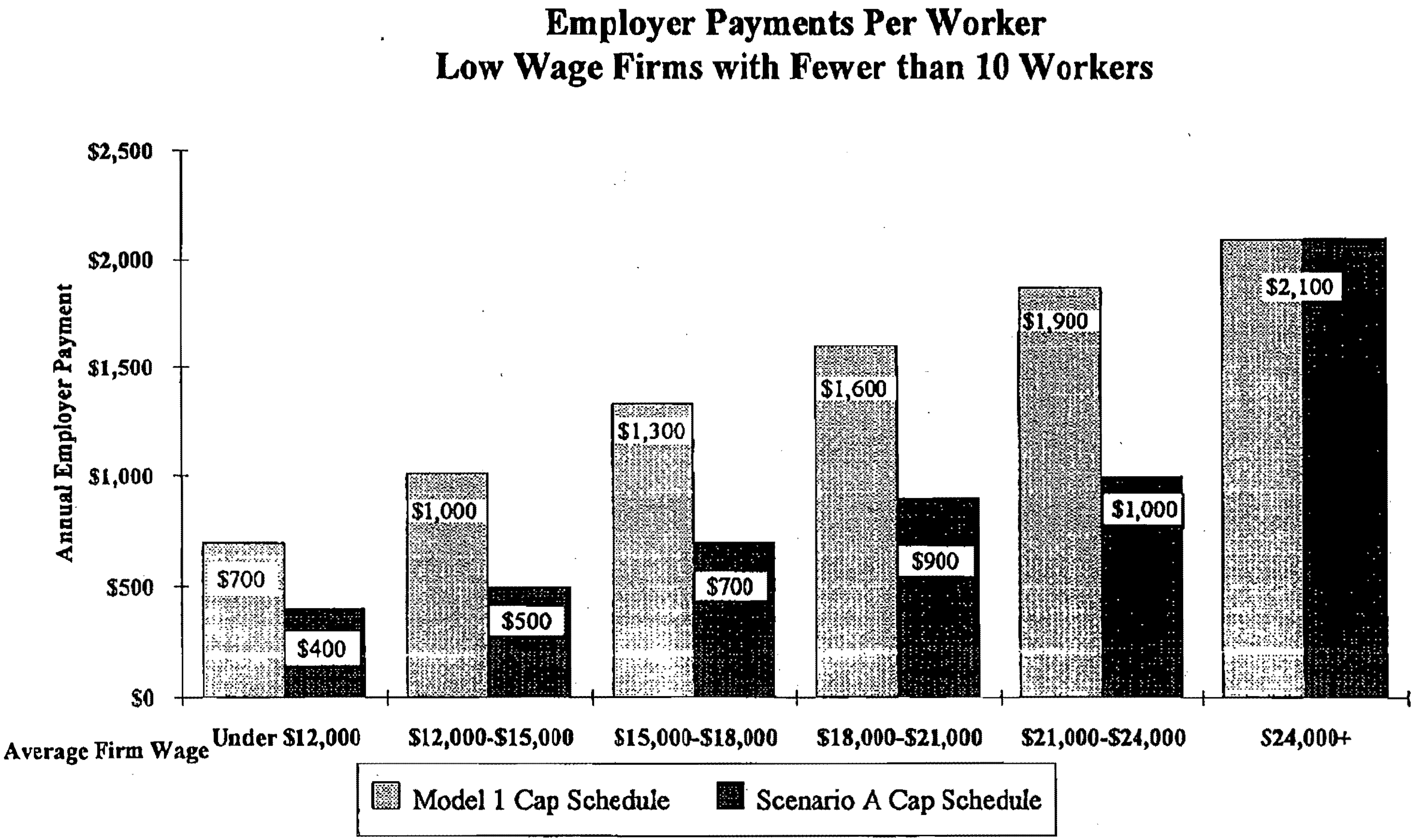
Deficit reduction (1996-2004)

relative to baseline..$45-55B

SCENARIO A

- **Increases subsidies to low-wage firms under 10, by lowering their individual wage cap by half.**

	Model 1	Scenario A
Average employer premium payment per family	**$2,200**	**$2,100**
For Smallest Lowest-Wage Firms		
Average employer premium payment per worker	**$700**	**$400**
Required employer premium payment per worker	**$600**	**$300**
Average family premium payment	**$600**	**$600**
Deficit reduction (1996-2004) relative to baseline	**$45-55B**	**$10B**



Employer Payments Per Worker
Low Wage Firms with Fewer than 10 Workers
Annual Employer Payment
$2,500
$2,000
$1,500
$1,000
$500
$0
$700
$400
$1,000
$500
$1,300
$700
$1,600
$900
$1,900
$1,000
$2,100
Average Firm Wage
Under $12,000
$12,000-$15,000
$15,000-$18,000
$18,000-$21,000
$21,000-$24,000
$24,000+
Model 1 Cap Schedule
Scenario A Cap Schedule

SCENARIO A: Potential Problems:

- Firm size gaming.
- Reduces deficit reduction.

SCENARIO B

- **Firms fewer than 10 workers are exempt from employer requirement.**
- **Exempt firms which voluntarily provide coverage receive subsidies.**
- **Employees in exempt firms must pay full premium, but no more than 3.9% of income.**

	Model 1	Scenario A
Average employer premium payment per family	$2,200	$2,100
Smallest lowest-wage firms		
• Average employer premium payment per worker	$700	$200
• Required employer premium payment per worker	$600	$0
Average family premium payment	$600	$600
Deficit reduction (1996-2004) relative to baseline	$45-55B	$0

SCENARIO B: Potential Problems:

- Firm size gaming.
- Administrative complexity for business, families & Government
- Equity.
- Maintenance of current payments.
- Cliffs.
- Eliminates deficit reduction.

SCENARIO C

- Employer / employee contribution is split 50/50, rather than 80/20. Employer subsidies same as Model 1.

- Family payments capped at 6% of income, instead of 3.9%.

	Model 1	Scenario C
Average employer premium payment per family	$2,200	$1,800
Smallest lowest-wage firms		
• Average employer premium payment per worker	$700	$700
• Required employer premium payment per worker	$600	$600
Average family premium payment	$600	$1000
Deficit reduction (1996-2004) relative to baseline	$45-55B	$80B

SCENARIO C: Potential Problems:

- Maintenance of current payments.

CONCLUSION

- Small firms already get substantial subsidies in Model 1.
- Lowering the employer share to 50% does little for smallest, lowest-wage firms since they already get substantial subsidies that effectively reduce their share below 50%.
- While a 50/50 split achieves deficit reduction, it does so at the expense of protection of families.
- Additional subsidies and an exemption from the employer requirement both would reduce small firm costs. However:
    - Additional subsidies do not create the administrative and equity problems associated with an exemption for small firms, and still achieve deficit reduction.
    - Exempting small firms increases premiums to other firms by shifting some health costs of exempt firms onto insuring firms. Increases family premiums for workers for exempt firms. Eliminates deficit reduction achieved in model 1.

EMPLOYER & FAMILY PAYMENTS UNDER VARIOUS SCENARIOS

with implications for deficit reduction

	Model 1	Scenario A	Scenario B	Scenario C
Avg. Employer Payment Per Family............	$2,200	$2,100	$2,100	$1,800
Payment Per Worker for Smallest, Lowest-Wage Firms:				
Avg. Employer Premium Payment......	$700	$400	$200	$700
Req. Employer Premium Payment......	$600	$300	$0	$600
Avg. Family Premium Payment....................	$600	$600	$600	$1,000
Deficit Reduction in billions (1996-2004).....	$45-55	$10	$0	$80

PROTECTING SMALL BUSINESS
INTRODUCTION

The purpose of this briefing is to address concerns you have expressed about making insurance coverage more affordable for small business in the context of an employer mandate.

Today, we'll explore three ways to accomplish this goal, keeping in mind the impact on deficit reduction. Remember, the greater the protection we provide to small businesses, the less deficit reduction we can achieve.

As we look at alternative strategies for small business, we will see that each has advantages and disadvantages. We will evaluate each, and then I will indicate my recommendation and solicit your views.

THREE WAYS SUGGESTED TO INCREASE SMALL BUSINESS PROTECTIONS

There are three approaches we will explore to lower the small business contribution for businesses with fewer than 10 employees:

A. **Provide greater subsidies.**

Small businesses pay less. Employees pay the same as under HSA. Government pays more because small businesses pay less.

B. **Exempt small businesses from the requirement to contribute to coverage.**

Small businesses are not required to pay anything. Their employees pay more. Businesses with 10 or more employees pay more. Government pays more in subsidies to families because family payments have gone up.

C. **Lower the share of premium businesses are required to pay, i.e. go from 80/20 to 50/50**

Businesses, on average, pay less. But as will be shown, lowering the share to 50/50 won't affect the smallest, lowest wage businesses because they already effectively pay less than 50 percent due to the generous subsidy structure. Employees pay more.

PROTECTING SMALL BUSINESSES
POTENTIAL PROBLEMS

There are 6 potential problems that arise from providing small businesses with special protections. We should keep these in mind as we evaluate each of the 3 approaches I'm going to present.

1. **Risk of firm size gaming.**

   More generous subsidies for smaller firms create incentives for large firms to splinter off into small firms to receive the better subsidies. As firms splinter off, government subsidies rise.

2. **Administrative complexity.**

   - Business: If some employers are exempt from the employer requirement or pay a lower share of the premium than others do, there will be more reporting and paperwork for all businesses in order to ensure that each worker is credited with the appropriate employer share.

   - Government: If some employers are exempt from the employer requirement, more individuals will be eligible for subsidies, and the government will have to administer subsidies to more people.

   - Families: Obviously, there are many more families than there are employers. If some businesses are exempt from the employer requirement, many more families will have to apply for subsidies.

3. **Equity.**

   The cost shift from small employers that do not insure their workers to non-exempt employers would continue under an approach that exempted small businesses from any requirement.

PROTECTING SMALL BUSINESSES
POTENTIAL PROBLEMS (CONTINUED)

4. **Maintenance of current payments.**

Today, on average, employers that insure contribute from 80 to 86 percent of the cost of premiums. If there is no requirement for small business or if the employer share is set at 50 percent, businesses may well continue to contribute what they contribute today. However, subsidies to lower income households or changes in the tax code may encourage businesses to drop coverage. Regardless of what actually happens, the public fears that employers, even if they now offer coverage to their workers, will reduce the level of coverage or choose to discontinue it altogether.

5. **Cliffs.**

Assume a firm with fewer than 10 employees is exempt from an employer requirement. When this firm decides to hire a tenth employee, the firm has to pay not only the cost of that worker's salary and health insurance but also the cost of providing health insurance to the other 9 workers as well. This creates large disincentives for firms to hire additional workers. Similar cliff effects occur when small businesses receive special subsidies.

6. **Deficit Reduction.**

As subsidies to small businesses increase, there is less deficit reduction.

HEALTH SECURITY ACT

As a reminder, let me once again outline the main elements of the Health Security Act.

Under the Health Security Act:

o **Employer/Employee Share.** Before subsidies, employers pay 80 percent of the average premium. Families are required to pay no more than 20 percent of average plan.

o **Employer/Individual Subsidies.** Subsidies may reduce premium payments. Firms with fewer than 5,000 employees pay no more than 7.9 percent of total payroll. Households pay no more than 3.9 percent of income for their premium share.

[Note: You may want to emphasize that the 3.9 percent limit applies only to the 20 percent premium share for the family -- this cap does not include any out-of-pocket spending.]

o **Small Business.** Small firms (with fewer than 75 employees) receive additional subsidies. The subsidy is increased by reducing the cap, on a sliding scale, from 7.9 percent to 3.5 percent of average firm payroll, with the cap level based on the number of employees and the average firm payroll.

o **Large Firms.** Firms with more than 5,000 employees which are outside the alliance pay 1 percent of payroll assessment.

MODEL 1 AS BASE OF COMPARISON

During the retreat, I presented four different models. Today, to best illustrate the tradeoffs between small business protection and deficit reduction, I have chosen Model 1 as the base model for comparison.

As a reminder, Model 1:

- Caps employer subsidies at 12 percent of each worker's individual wage, rather than 7.9 percent of average firm payroll as under HSA. For firms with fewer than 75 employees, the subsidy is increased by reducing the cap, on a sliding scale, from 12 percent to 5.5 percent of each worker's wage, with the cap level based on the number of employees and the average firm payroll.

- Caps payments for working families at 3.9 percent of income.

- Reduces firm size threshold for community rating from 5,000 to 1,000. Assesses firms with more than 1,000 employees 1 percent of payroll. All firms are eligible for employer subsidies.

	Model 1
Avg. employer premium payment per family	$2,200
Smallest, lowest-wage firms:	
Avg. employer premium payment per worker	$700
Required employer premium payment per worker	$600
Avg. family premium payment	$600
Deficit reduction (1996-2004) relative to baseline	$45-55

* Employer premium payment per <u>worker</u> is $2,000.

<u>Implications:</u>

- This better targets employer subsidies to businesses with low-wage workers. Since employers will no longer receive subsidies for higher wage workers, employer premium payments will be slightly more.

- Total federal subsidy costs are reduced relative to the HSA because employers no longer receive subsidies for higher wage workers.

SCENARIO A

Today, I'm going to walk you through 3 scenarios that show options for addressing small business concerns. However, there are tradeoffs between increased protection for small businesses and deficit reduction. The more protection for small business, the less deficit reduction. Conversely, the less we do for small business, the more deficit reduction we can achieve.

Scenario A increases the subsidies for the smallest, low-wage businesses relative to Model 1.

- o Scenario A is identical to Model 1, except that the subsidies to low-wage firms with fewer than 10 employees are increased.

- o As you recall, under Model 1, firms with fewer than 75 employees paid only 5.5 percent to 12 percent of each worker's wages. Under Scenario A, we've gone one step further for firms with fewer than 10 with low and moderate wage workers. We've reduced the 5.5 percent to 2.8 percent. That means that the smallest, lowest-wage firm doesn't have to pay any more than 2.8 percent of each worker's wage for health insurance. Obviously, the small firm cap can be increased or decreased depending on how much protection we want to give small firms and how much we want the federal government to spend.

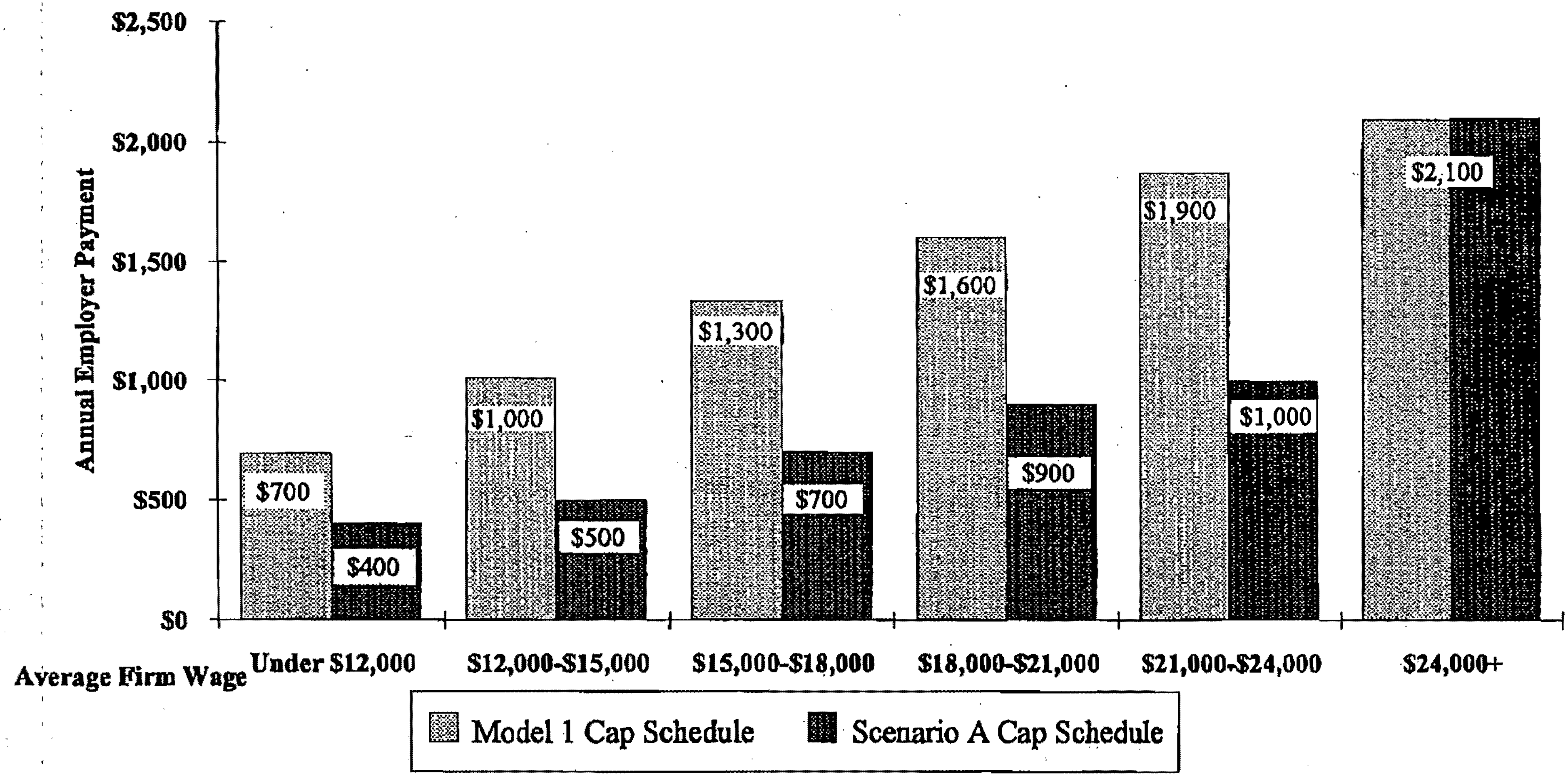
SCENARIO A

	Model 1	Scenario A
Avg. employer payment per family	$2,200	$2,100
Smallest, lowest-wage firms:		
Avg. employer premium payment per worker	$700	$400
Req. employer premium payment per worker	$600	$300
Avg. family premium payment	$600	$600
Deficit reduction (1996-2004) relative to baseline .	$45-55	$10

Implications:

- o Families pay the same as under Model 1.
- o Reduces deficit reduction because government subsidies are higher.

Employer Payments Per Worker
Low Wage Firms with Fewer than 10 Workers



SCENARIO A
CHART

- Remember that under Model 1, the smallest, lowest wage firms get a large break -- they pay just $700 per worker.

- [Refer to chart] This chart focuses on what firms with fewer than 10 employees pay. These firms, representing 78 percent of all firms, pay considerably less than under Model 1:

  - With the even larger subsidies under Scenario A, firms with fewer than 10 employers with an average payroll of less than $12,000 pay, on average, $400 per worker. This is a huge break for the smallest, lowest wage business.

  - If we look at firms with fewer than 10 employees with an average payroll of $18,000 to $21,000, they pay, on average, $900 per worker.

  - As a small firm's average payroll increases, its subsidies aren't as great. Once you reach $24,000, the additional subsidies for small businesses no longer apply. As you can see, small firms with average payroll of more than $24,000 pay the same amount under this scenario as they do under Model 1 -- $2,100.

SCENARIO A
POTENTIAL PROBLEMS

- **Risk of firm size gaming.** Better small firm subsidies create incentives for large firms to splinter off into small firms to receive the better subsidies. As firms splinter off, government subsidies rise.

- **Deficit reduction.** More generous subsidies increase federal spending, resulting in $10 billion in deficit reduction, compared to the $45-$55 billion in deficit reduction under Model 1.

SCENARIO B

- o Identical to Scenario A, except that firms with fewer than 10 employees are exempt from the employer requirement. If firms under 10 voluntarily provide coverage, they receive subsidies.
- o People working for firms with fewer than 10 employees are responsible for paying the full premium, but are not required to pay any more than 3.9% of income. Under the HSA, the 3.9 percent cap applies only to the 20 percent family share of premium.

	Model 1	**Scenario B**
Avg. employer payment per family	$2,200	$2,100
Smallest, lowest-wage firms:		
Avg. employer premium payment per worker	$700	$200
Req. employer premium payment per worker	$600	$0
Avg. family premium payment	$600	$600
Deficit reduction (1996-2004) relative to baseline .	$45-55	$0

Implications:

- o Families pay the same as under Model 1.
- o Eliminates deficit reduction.

SCENARIO B
POTENTIAL PROBLEMS

- **Risk of firm size gaming.** Incentive for firm size gaming may be greater than Model 1.

- **Administrative complexity.** Businesses will have more reporting and paperwork requirements; government will administer subsidies to more families; and more families will have to apply for subsidies.

- **Equity.** Premiums for businesses of 10 or more are higher due to the cost shift from firms that don't insure to those that do.

- **Maintenance of current payments.** CBO is likely to assume that employers that currently provide insurance will continue to do so. Regardless of what economists say, however, people fear that employers, even if they now offer coverage to their workers, will choose to discontinue it.

- **Cliffs.** Cliffs are particularly problematic in this scenario, because firms go from paying nothing to paying the full requirement for all of their workers when hiring the 10th worker.

- **Deficit Reduction.** Exempting small firms from employer requirement results in no deficit reduction, compared to between $45-$55 billion in deficit reduction under Model 1.

SCENARIO C

- o Identical to Model 1, except with a 50/50 employer/ee contribution rather than an 80/20 contribution. The employer subsidies are same as under Model 1.

- o Family payments capped at 6 percent of income, instead of 3.9 percent as under Model 1. The cap is raised for family payments because their required contribution goes from 20 percent to 50 percent. Raising the family share to 50 percent and still maintaining the 3.9 percent cap would require very large government subsidies.

	Model 1	Scenario C
Avg. employer payment per family	$2,200	$1,800
Smallest, lowest-wage firms:		
Avg. employer premium payment per worker	$700	$700
Req. employer premium payment per worker	$600	$600
Avg. family premium payment	$600	$1,000
Deficit reduction (1996-2004) relative to baseline .	$45-55	$80

Implications:

- o As you can see, the 50/50 contribution does not reduce costs for the smallest, lowest wage businesses, since their payments are already effectively below 50 percent due to the generous subsidy structure of Model 1.

- o Government pays less.

- o Families would pay significantly more, $1,000 compared to only $600 under Model 1.

SCENARIO C
POTENTIAL PROBLEMS

o <u>Maintenance of current payments</u>. CBO is likely to assume that employers that currently provide insurance will continue to do so. Regardless of what economists say, however, people fear that employers will choose to discontinue coverage for their workers.

EMPLOYER & FAMILY PAYMENTS UNDER VARIOUS SCENARIOS

with implications for deficit reduction

	Model 1	Scenario A	Scenario B	Scenario C
Avg. Employer Payment Per Family............	$2,200	$2,100	$2,100	$1,800
Payment Per Worker for Smallest, Lowest-Wage Firms:				
Avg. Employer Premium Payment......	$700	$400	$200	$700
Req. Employer Premium Payment.......	$600	$300	$0	$600
Avg. Family Premium Payment....................	$600	$600	$600	$1,000
Deficit Reduction in billions (1996-2004).....	$45-55	$10	$0	$80

CONCLUSION

- o Small businesses already receive substantial protections under Model 1.

- o Since the smallest, lowest wage businesses are already protected below 50 percent of the premium through the subsidies, lowering the required employer share of the premium to 50 percent provides no additional benefit to these businesses. Although reducing the required employer share from 80 percent to 50 percent achieves deficit reduction, it does so at the expense of protection of families.

- o The two other scenarios - providing greater subsidies and exempting small businesses from the requirement to contribute to coverage - provide substantial further protection for small businesses. But they are not equal in my view. The first scenario - providing greater subsidies to small business - achieves this goal with minimal structural problems, though it reduces the deficit reduction we can achieve. The second scenario -- exempting small businesses altogether -- shifts costs onto families and eliminates deficit reduction. It also has other structural problems which make it a less attractive alternative.

- o Given these tradeoffs, if we want to do more for small businesses, I recommend providing greater subsidies to small business by further lowering small business caps. It's the most equitable and the least complicated.