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Small employers and expanded health insurance coverage

Direct and indirect costs and uncertainty limit participation

By Phil Primack

The real action on plans to expand health insurance coverage is at the state level. As Wal-Mart Director of State Health-Care Policy Joe Quinn put it at a New England Public Policy Center conference about covering the uninsured, "This game is with CEOs and with governors."[1]

New England states have been national leaders in developing and enacting health insurance programs. But as the new laws play out on real ground, various constituencies are seeing real or perceived devils in the detail of the expansion laws. For one group in particular—small employers—efforts to extend coverage have become a two-edged sword. On the positive swing, the new plans offer small businesses that do not offer employer-provided plans a way to get their workforce covered. And healthier employees are generally more productive employees. But the other swing means higher labor costs, greater administrative hassles, additional requirements and, in some cases, mandates. This policy brief focuses on some of the challenges facing small employers as the health insurance expansion process continues to evolve, drawing on interviews with people in or working at the state level with small businesses.

Snapshot of small employer coverage

Employees working for large employers are significantly more likely than those employed by small firms (fewer than 50 employees) to be eligible for and/or covered by employer-based health insurance (see chart on next page). For both New England and the nation, just over 71 percent of those working for larger firms had company-based insurance in 2004, compared to about 50 percent of those working for smaller businesses.

To some extent, these coverage numbers may reflect the very nature of small business, which faces less market predictability, generally lower profit margins, and often has a greater dependence on part-time or seasonal workers. But according to small employers, the biggest reason for offering little or no health insurance coverage is cost.

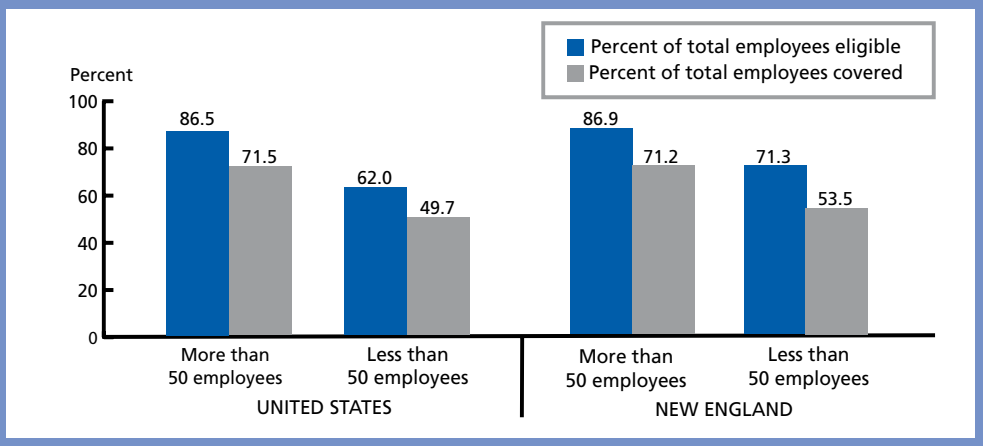
Unlike large employers, many of which are either self-insured or are able to use their size to negotiate both greater benefits and lower premiums, small employers lack such leverage. Also unlike larger companies, small businesses are less able to afford either in-house human resources personnel or consultants to help them navigate new and often changing health care regulations.

Small firms that do cover a significant share of their employees' health care premiums are finding it increasingly costly to do so. "We are getting hit with larger rate increases each year than larger employers," said Philip M. Papoojian, President and Chief Operating Officer of Metachem Resins Corporation (MERECO) in West Warwick, RI, and chair of the health care subcommittee for the Rhode Island Economic Summit. "It has to do with the small group rating. There is a real disparity between the premium rates insurers give larger (50 or more employees) and smaller companies (fewer than 50 employees)."

In general, smaller firms face higher premiums because the size of the insured pool

Eligibility and coverage rates

Full-time, private-sector employees, 2004



Source: Author's calculations based on 2004 Medical Expenditure Panel Survey

is one of the factors used by insurers to price risk. In addition, because they cannot afford to self-insure because of their size, small business are unable to avoid state-mandated benefits, such as infertility treatments, that add to premium costs. Administrative costs can be more burdensome for smaller firms as well.

Papoojian, for example, received notice this past spring of a nearly 23 percent increase in health insurance premium costs for his 23 employees. That premium hike translates into an additional $43,000, bringing his company's spending just on health insurance premiums to nearly $250,000 a year. While his premiums are especially high because of the over-50 average age of his workforce, Papoojian said insurers in Rhode Island have placed firms with one to five employees in the highest risk group. "One legislative proposal wanted to segment the small group market from one to five, and then from 25 to 50 employees. The larger group would have seen rates go down, but firms with fewer than five employees would have incurred large increases, and such firms make up a lot of all businesses in the state." (In Rhode Island, 85.1 percent of all firms had fewer than 20 employees in 2004, which was about the same proportion as for New England as a whole and slightly under the national rate of 89.3 percent.[2])

Costs and complexity limit participation

Across New England, efforts to expand health coverage have included a special focus on small businesses. But so far, such efforts have met limited success. Costs are a key factor for both individuals and employers alike. For example, enrollment in Maine's DirigoChoice program has been much less than anticipated, due in part to its cost and benefits structure but also to the daunting challenge of getting the uninsured—especially younger, healthier individuals—to be willing to get insurance, said Kristine M. Ossenfort, Senior Governmental Affairs Specialist for the Maine State Chamber of Commerce.

DirigoChoice was originally projected to cover 100,000 people, including about 31,000 in its first year. Actual first-year enrollment was just 7,500 people. Enrollment as of May 2007 was 15,800,[3] "but that is just not going to have a significant impact when Maine's uninsured population is about 125,000 people," said Ossenfort. Few individuals leave DirigoChoice, but those who do are more likely to be young and healthy. Those who voluntarily left the program cited costs, inadequate benefits, and other issues, such as dissatisfaction with administration of subsidies. They also felt that "Dirigo wasn't going to last."

The DirigoChoice program also expected greater participation rates by businesses. However, the program requires employers to pay at least 60 percent of employees' premium costs before they can enroll in the program, which can be a significant hurdle for small businesses. According to a recent *New York Times* article, the problems with enrollment in Dirigo Health are also related to some "particular challenges" faced by Maine, which has large rural, low-income and elderly populations with significant health care needs, a large number of small businesses and part-time or seasonal workers, and few employers that voluntarily can offer health insurance to employees.[4]

Another problem—in all states—is that health care is a complex issue to take on, especially for small businesses that often lack in-house expertise. "When you talk about taxes or labor issues or something with clearer impact, it's easier to motivate businesses," says Ossen-

fort. "But health care is complicated, with so many moving pieces. Many small business owners feel a sense of powerlessness, that they can't do anything. Even people like me, who watch this all the time, don't get the nuances."

Massachusetts is addressing participation issues head-on by imposing both individual and employer mandates for health insurance coverage. Enrollment by individuals in the state's subsidized CommonwealthCare plan has exceeded expectations. For example, as of June 1, about 79,000 people—roughly half of the eligible population earning less than 300 percent of the federal poverty level—had already been enrolled. Most of these new enrollees were automatically enrolled, having previously received payment for medical services through the state's Uncompensated Care Pool since they lacked other coverage.

"By and large, the smaller the company, the less likely it is to offer insurance," said Eileen McAnneny, Vice President of Government Affairs for Associated Industries of Massachusetts. Because a smaller percentage of them offer coverage to begin with, smaller firms are disproportionately feeling the effect of the employer mandate.

Indirect costs and uncertainty also concern small employers

Unlike other New England states, Massachusetts will require all individuals to have health insurance by July or face financial penalties, beginning with loss of their personal income tax exemption in 2007. As part of its landmark law, the state also requires employers with 11 or more employees to make a "fair and reasonable" premium contribution to a qualified plan[5] or pay $295 for each employee for whom it does not. When the individual mandate becomes effective in Massachusetts, McAnneny said some workers who have opted out of employer-based coverage might decide that it is cheaper to go with the employer plan than face the state penalty. If more employees suddenly enroll in their employers' plans, it "carries real financial consequences for employers who have not budgeted for such a cost increase," said McAnneny.

Besides such direct additional costs, smaller businesses face sometimes unanticipated indirect costs as a result of state health coverage expansion. For one thing, they must comply with a range of new reporting and other administrative requirements. As part of the Massachusetts law, for example, premiums for workers will be lower if their employers set up "Section 125" plans that treat employees' premiums as pre-tax income. All employers with 11 or more full-time equivalent employees must have such plans in place by July 1.

That raises another concern: uncertainty. "Some small businesses worry that over time requirements will change, leading to higher levels of premium contributions or higher levels of participation among employees," said McAnneny. "Such uncertainty and unpredictability cause angst—companies want to know what the law is so they can choose to provide coverage or pay the annual per-employee fee of $295."

It is unclear whether the employer assessment will have a major effect on the percentage of firms offering health insurance. Because the "fair share" premium contribution requirement towards providing coverage for a given worker is much higher than the $295 assessment, it is unlikely that more employers will choose to offer coverage. Yet some worry that firms that already offer health insurance may see a significant increase in the number of workers taking up the benefit, which may increase costs to the point that such employers decide to drop coverage altogether. However, given that many of the firms that already offer health insurance are likely to do so for competitive reasons, some analysts anticipate that relatively few would likely drop coverage in response to the employer mandate.

Other states, other approaches

Compared to other New England states, Rhode Island is taking a more modest approach to insurance reform. In April, the state announced that this fall, private insurers would begin to offer two new plans offering discount rates to employees of small businesses who agree not to smoke and take various measures to keep fit, such as health screenings. Premiums for the discounted plans cannot exceed 10 percent of an average worker's annual wages. In Rhode Island, the monthly individual premium target is $314.

Papoojian says small employers welcome any relief from double-digit rate increases. "The concept and the benefit design of these plans are excellent," he said. "The challenge is to market it properly to the right people."

In Vermont, small employers are facing new financial obligations as that state's plan

to cover some of the uninsured—Catamount Health—takes effect. Beginning July 31, employers will pay a $1 per day fee for every full-time equivalent employee who does not have health insurance coverage. Some employers say they are having a hard time understanding and complying with new requirements in order to calculate the payments they must make. They must, for example, determine not only which of their employees are not enrolled in the company health plan, but also which have insurance through another job or spouse.

Senator Richard Mazza, a small business owner himself who voted for the plan with its employer assessment, said that even he is having hard time understanding the requirement. "There are going to be a lot of small businesses that are going to be complaining," he said.[6]

In Maine, Ossenfort said she does not think employer mandates are the best way to generate greater small business participation in state plans to expand health coverage. "The reason most small businesses don't offer insurance isn't that they don't want to—they can't afford to. And a mandate doesn't make it any more affordable for them.

"The incentive for business to offer health insurance is already there—retention and recruitment of workers," Ossenfort continued. "Getting out the message that they are in a better position by offering coverage is more effective than punishing them for not offering it."

States' success in getting out that message may prove more effective than formal mandates in getting businesses, especially small ones, to offer health plans to their employees. The challenge for policy makers remains to convince small employers that the carrot of a healthier workforce and the social responsibility to provide coverage more than offset the stick of higher costs.

Endnotes

[1] "Covering the Uninsured: Costs, Benefits, and Policy Alternatives for New England." New England Public Policy Center at the Federal Reserve Bank of Boston conference. December 5, 2006. http://www.bos.frb.org/economic/neppc/conferences/2006/uninsured/index.htm

[2] Small Business Administration, based on data from the U.S. Census Bureau.

[3] http://www.dirigohealth.maine.gov/

[4] Belluck, Pam. "As Health Plan Falters, Maine Explores Changes." *The New York Times*. April 30, 2007.

[5] A qualified plan is defined as either (1) at least 25 percent of the employer's full-time employees are enrolled in the employer's group health plan, or (2) the employer offers to contribute at least 33 percent of the premium cost of its health plan to all full-time employees.

[6] Remsen, Nancy. "Vermont Employers Grapple with Health Care Fee." *Burlington Free Press*. February 11, 2007.

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