

Health Insurance Reform and Small Businesses
U.S. Senate Committee on Small Business and Entrepreneurship
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Thank you, Chair Landrieu, Ranking Member Snowe and members of the Committee. I'm Gene Sperling and I serve as Counselor to Treasury Secretary Geithner. It's an honor to testify before you on the importance of health insurance reform for America's small businesses.

Small Businesses are Critical to Our Economy. I hardly need to tell this Committee what a crucial engine of job creation small businesses are for the American economy. Small businesses account for about one half of all jobs created in America,¹ and history – including the past two recessions – shows that the growth of small to midsize firms tends to lead economic recoveries.² The ability of entrepreneurs to explore new ideas, to take risks, to be their own bosses and to respond nimbly to changing market conditions contribute to the dynamism and innovation in our economy. And small businesses are critical to economic mobility, providing a ladder that generations of Americans have used to climb into a position of economic security for their families.

Our Current Health Care System Discriminates against Small Businesses and their Employees. Unfortunately, when it comes to health care, we have a status quo that discriminates against small businesses. As Chair Landrieu pointed out in a recent Wall Street Journal editorial, small businesses compete not just against each other but against larger businesses as well — both for customers and for employees. Under our current system, the deck is stacked against them, putting them at a severe disadvantage in competing with big businesses and international competitors. And this discrimination is passed through to small business employees, who are worse off than their peers working for big businesses. As Christina Romer, Chair of the President's Council of Economic Advisors, put it in recent testimony, "the current U.S. health care system imposes a heavy tax on small businesses and their employees."³

This discrimination against small businesses takes a number of forms, but I want to focus on a few key areas.

The Status Quo Discriminates against Small Businesses Based on the Illness of Employees. Under our current system, a small business with just one or two workers who get really sick can face enormous premium increases — penalizing illness and defeating the entire purpose of insurance. Under the status quo, insurance companies can set premiums based on the health status and claims experience of the workers they cover. If a small business has even one employee who needs a kidney transplant or expensive cancer treatments, this can be enough to vastly increase the average cost of covering the small business. Currently, insurers can respond by increasing the firm's premiums without any limits.

¹ Bureau of Labor Statistics, "Business Employment Dynamics: Fourth Quarter 2008," August 19, 2009.

² Brian Headd, "Small Businesses Most Likely to Lead Economic Recovery," Small Business Administration Office of Advocacy, July 2009.

³ Christina D. Romer, Statement before the Committee on the Education and Labor of the U.S. House of Representatives, June 23, 2009.

This system runs counter to the basic principle behind health insurance, which is supposed to spread the cost of unexpected hardship. In addition, the millions of dollars that insurance companies spend on actuaries and underwriters to determine the health status of small businesses gets passed on to these businesses — increasing their premiums regardless of their health status.

The Status Quo Discriminates Against the Health Coverage Opportunities for Employees of Small Businesses.

Because of the high costs and price instability described above, many small businesses do not offer health insurance to their workers. Just 46 percent of firms with 3 to 9 workers and 72 percent of firms with 10 to 24 workers offer health insurance, compared to 98 percent of large firms with 200 or more employees.⁴ This lack of employer-sponsored coverage would be less of a problem if workers that were not offered insurance by their employers could easily purchase it on their own. But the current individual market is a highly unsatisfactory alternative, leaving the many small firms that can't afford to offer insurance — and their workers — at a severe disadvantage.

The individual market suffers from many of the same flaws as the small group market. For individuals seeking coverage, a lack of bargaining power, high administrative costs, and high brokers' fees result in high and unstable premiums and out-of-pocket costs. According to CBO, nearly one of out every four dollars collected in premiums in the individual market is spent on administration and overhead rather than medical care.⁵ This compares to just 6 percent in the large group market.⁶ These higher administrative costs contribute to high premiums in the individual market. Individuals who get sick can see their premiums raised to even more unaffordable levels, just when they need coverage the most. In addition, insurers can refuse to cover treatments for preexisting conditions, leaving individuals without coverage for the health problems for which they're most likely to need care. Indeed, in some cases insurance companies can simply cancel policies if individuals become a bad insurance risk. Yet even for relatively healthy workers, the cost of insurance can be prohibitive.

These shortcomings place small businesses that can't afford to cover their workers at a severe disadvantage. They have more trouble attracting and holding on to good workers. According to a 2007 Gallup poll, 84 percent of small-business owners believe that having an adequate health insurance program would help their companies attract the best qualified employees, 83 percent believe it would reduce the likelihood that their employees would leave, and 81 percent believe it would make employees more loyal to their companies. Small businesses that don't offer coverage also face lower productivity and higher absenteeism as their workers suffer from unnecessary illness, come into work sick, or are forced to spend all day at an emergency room with a sick child because they don't have a regular doctor. According to the 2007 Gallup poll, two-thirds of small business owners said that having adequate health insurance would make their employees more productive.⁷

⁴ Kaiser Family Foundation and Health Research and Educational Trust (2009).

⁵ Congressional Budget Office, Letter to Chairman Baucus, Sept. 22, 2009.

⁶ Congressional Budget Office, "Key Issues in Analyzing Major Health Insurance Proposals," December 2008.

⁷ Gallup News Service, "Small-Business Owners See Need for Healthcare Overhaul," October 5, 2007.

While this status quo is already unacceptable, health care discrimination against small firms shows signs of worsening over time. Among firms with 3 to 9 workers, the fraction offering health insurance fell from 58 percent in 2002 to 46 percent in 2009. In the past year alone, the share of firms with between 10 and 24 workers that offer insurance declined from 78 to 72 percent.⁸ According to a recent study by Small Business Majority, the annual profits that small businesses lose due to health care costs will increase more than 10-fold over the next 10 years with accelerating job loss as well.⁹

The Status Quo on Health Care Costs Discriminates Against Small Businesses through Higher Administrative Costs and Higher Premium Prices. Small businesses face price discrimination that puts them at a competitive disadvantage compared to their larger competitors. Small businesses pay up to 18 percent more for the exact same health insurance as big businesses do.¹⁰ These higher costs eat into the bottom line of small businesses, reducing what they can pay their workers, invest in their operations, and retain in profits.

There a number of reasons for these higher prices. Small firms have less bargaining power than their larger competitors. They pay higher brokers' fees than do larger firms.¹¹ And because health insurers' administrative costs can be spread over more employees in large firms, premiums for small firms include up to three times as much in administrative costs as premiums for large firms.¹² In addition, small firms face higher costs to select and enroll in a plan, with the same Human Resource duties spread over fewer workers than at large firms.

In short, our status quo health care system forces too many small businesses to choose between two bad options. They can offer insurance and face high prices and the prospect of sudden price increases, or they can leave their workers to the high prices and unfairness of the individual market. And if nothing is done, the choices for small business will be even worse in years ahead.

The Need to Move Beyond a Status Quo that Discriminates against Small Businesses. The discrimination against small businesses and their employees makes no sense from an economic, health or moral point of view. From an economic perspective, it distorts economic incentives around firm size. It also deters entrepreneurship and small business formation by locking workers — especially those with families or with any sort of health problem — into jobs at large firms. As noted in a recent paper by the Council of Economic Advisors, “The high prices of health insurance in the non-group and small group markets and the possibility that a pre-existing condition will prevent a worker from obtaining coverage at any price distort individuals' career choices [and] create the phenomenon of “job lock,” causing many workers to remain in their jobs at large firms even if they would be more productive and better paid at a small business.”¹³

⁸ Kaiser Family Foundation and Health Research and Educational Trust (2009).

⁹ Small Business Majority, “The Economic Impact of Healthcare Reform on Small Business,” June 11, 2009.

¹⁰ Jon Gabel et al., “Generosity and Adjusted Premiums in Job-Based Insurance: Hawaii is Up, Wyoming is Down.” Health Affairs, 2006, 25(3): 832-843.

¹¹ Leslie J. Conwell, “The Role of Health Insurance Brokers: Providing Small Employers with a Helping Hand,” Health System Change Issue Brief No. 57, October 2002.

¹² Congressional Budget Office, “CBO’s Health Insurance Simulation Model: A Technical Description.” October 2007.

¹³ Council of Economic Advisors, “The Economic Effects of Health Care Reform on Small Businesses and their Employees,” July 25, 2009.

The discrimination in our system also makes no sense from the perspective of public health. Why should we simply accept a status quo that encourages employer-provided health care, unless you choose to work for a small business? Today, 29 percent of non-elderly workers at small firms are uninsured, compared to just 10 percent of workers at large firms.¹⁴ This translates into millions of people left needlessly uninsured and going without the care they need, including treatments like vaccination that are important for everyone's health.

And from a moral perspective, it is just counter to our values to have parents who work at small businesses going to sleep every night with the fear that a single serious illness or accident affecting them or their children could lead to financial devastation and inferior medical coverage for their loved ones. Our nation can do better.

How Health Reform Addresses these Problems. While there are still different versions of health reform moving through both Houses of Congress, we are pleased that all of them seek reforms that would address the major problems outlined above:

- 1. Increasing Affordability of Small Business Health Insurance:** The health reform bills making their way through Congress include several important measures that will make it more affordable for small businesses to provide health insurance to their workers. The bills create insurance exchanges that would act as streamlined marketplaces where small businesses and perhaps larger businesses could compare and purchase insurance plans. Offering through the exchange will allow small businesses to avoid the higher administrative costs and brokers' fees they currently face. Exchanges also give small businesses the ability to pool their market power to lower premiums, allowing them to compete on a more equal footing with large businesses. According to CBO, under the Finance Committee bill, this option will cover 4 million workers by 2019 while giving the small businesses that enter the exchange the ability to get health care at lower costs, with the prospect of being able to offer higher wages to their workers.

The bills also include provisions that would require insurers to publicly disclose their "medical loss ratios" — the fraction of premium revenues they dedicate to paying for medical services as opposed to administrative costs, marketing, and profits. Making this information public will give small businesses better information to choose among insurers, and it could create an important incentive for insurers to spend less on things besides medical care. The House bill goes one step further, requiring insurers that spend less than a certain share of their receipts on medical care to refund the shortfall to those they insure.

And the bills include a small business tax credit that will reimburse small businesses for a substantial portion of their health care costs — under the Finance bill, for example, this credit would cover up to 50 percent of a small business's health insurance costs. The HELP and House bills include similar provisions. In combination with the tax advantages small businesses already enjoy for offering health insurance, these measures will make it much more affordable for small businesses to cover their workers.

¹⁴ Council of Economic Advisors, "The Economic Effects of Health Care Reform on Small Businesses and their Employees," July 25, 2009.

2. **No More Unfairly Penalizing Small Businesses Based on Illnesses of Employees.** Under both the Finance Committee and HELP Committee bills, health insurers in the individual and small group markets would be required to set rates based on “modified community rating,” which basically means they can’t set their rates based on the health status or claims experience of the workers they cover. This rule will have two important benefits for small businesses.

First, small business owners will no longer need to worry that their premiums will be raised if their workers get sick. Even if one of your workers suddenly needed a \$200,000 liver transplant, your insurance company couldn’t raise your premiums even one dollar. They also couldn’t refuse to renew your policy. The insecurity that is built into the current system will be gone.

Second, insurance companies that insure small businesses (and individuals) will no longer have a reason to spend millions of dollars on actuaries and underwriters to figure out how much to charge you. These costs may add 2 percent or more to premium costs in the small businesses and individual markets.¹⁵ Eliminating these costs could reduce premiums for all small businesses, whether their workers are high-cost or not.

3. **Improving Options for Small Business Employees and Self-Employed in the individual market.** The reform bills will make major improvements in the individual market to help small business employees at firms that don’t offer coverage. Individuals will benefit from important market reforms, including eliminating price discrimination based on health status, eliminating the exclusion of pre-existing conditions, and guaranteeing the issue and renewal of insurance contracts. Individuals will be able to purchase insurance through the health care exchanges, where according to the Congressional Budget Office (CBO), administrative costs will be reduced by about 20 percent.¹⁶ According to CBO, 23 million Americans will choose this option by 2019. And low- and moderate-income individuals will be eligible for subsidies to help them afford coverage. In short, the individual market will become a viable alternative to employer-sponsored health insurance, alleviating the discrimination against workers at small firms that don’t offer health insurance.

Conclusion. Under the status quo, our health care system discriminates against small businesses and small business employees, harming our economy and our future. As President Obama said earlier this month, health reform will mean that “entrepreneurs can pursue the American Dream again, and our small businesses can grow and expand and create new jobs again.”¹⁷

Thank you again for your efforts in health insurance reform to help small businesses. I look forward to hearing your comments and questions.

¹⁵ Mark Merlis, Simplifying Administration of Health Insurance, National Academy of Social Insurance, January 2009.

¹⁶ Congressional Budget Office, Letter to Chairman Baucus, Sept. 22, 2009

¹⁷ President’s weekly radio address, October 3, 2009.