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ACCESS TO HEALTH INSURANCE

States Attempt to Correct Problems in Small Business Health Insurance Market

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SUMMARY OF TESTIMONY
BY
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SUBCOMMITTEE ON HEALTH AND THE ENVIRONMENT
HOUSE COMMITTEE ON ENERGY AND COMMERCE

Many small business employees are unable to obtain health insurance through their employers, and they and their dependents constitute a substantial portion of the uninsured population. Nearly all states have recently enacted or proposed measures designed to improve access to affordable health insurance for small-business employees --many of these state initiatives have occurred in the last two years. Congress asked GAO to assess the extent of such state activities and to report on any early assessments of their effectiveness.

Some states have restricted insurance company practices that have made health insurance difficult or impossible to obtain under several conditions: if an insured worker, co-worker, or family dependent has an expensive medical condition; if a worker changed jobs; or if an employee changed insurance companies. Some states have also tried to ease the financial burden confronting small firms offering health insurance to their workers by eliminating mandated benefits, or through experiments with subsidized premiums or premium tax credits.

It is difficult to assess the ultimate impact of these state initiatives because many of them have been introduced within the past two years. Early indications are that they have led to only modest gains in the number of firms offering health insurance. Apparently, the elimination of mandated benefits has not lowered premiums enough to make a significant difference in affordability and the reduced-mandate plans generally include other restrictions that limit a plan's attractiveness to employers. Subsidies and tax credits, likewise, have not been sizeable enough to encourage firms to offer health insurance. Indeed, certain insurance market reforms may result in much lower premiums for a few firms with high-risk employees, but at the same time they may result in higher premiums for other small firms that have largely low-risk employees.

These reforms address some of the major problems in the small group market, and they have helped a number of small business whose owners want to offer health insurance. Ultimately, however, small business market reforms may have only a limited effect on the affordability of health insurance for most small businesses. Cost is the main barrier to coverage and continues to be under these reforms.

Mr. Chairman and Members of the Committee:

I am pleased to be here today to testify on our report on state efforts to improve the availability and affordability of health insurance for small businesses. We prepared the report at the request of the Energy and Commerce Committee and the Subcommittee on Regulation, Business Opportunities and Energy of the Small Business Committee.[1]

As we have previously testified before this committee, small business employees and their dependents constitute a substantial portion of the uninsured population. Because of major problems in the small group health insurance market, such as insurer refusal to cover those with preexisting medical conditions, many small business employees are unable to obtain health insurance through their employers.

In brief, in this report we found that most states have proposed or already implemented programs to try to expand small business employees' access to coverage. Many of these initiatives have been adopted within the past two years, but early indications are that they have led to only modest gains in the number of firms offering health insurance largely because costs have not been reduced sufficiently to induce small firms to offer health insurance.

BACKGROUND

Over three-quarters of Americans who lack health insurance are workers or their dependents, and about half of these uninsured workers are in firms with 25 or fewer employees. Small business owners consistently cite cost as the chief reason they do not provide health insurance to their employees.

The problem of escalating health care costs is especially acute for small businesses, where employer profits and employee wages may be low. Because of their disadvantaged position in a highly competitive health insurance market, small businesses are more likely than larger firms to face higher premium costs, as well as denial or cancellation of coverage. A recent national survey found that 30 percent of small firms surveyed are considering dropping health insurance

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[1]A companion GAO study, which will soon be released, explores the broad range of state health care reforms, including efforts to guarantee universal access to coverage. U.S. General Accounting Office, Access to Health Care: States Respond to Growing Crisis (GAO/HRD-92-70, June, 1992).

benefits because of the cost.[2] Thirteen percent of respondents to the same survey indicated they had dropped coverage within the preceding three years. Another factor contributing to lack of coverage for small business employees is that some employers do not regard the provision of health benefits as their responsibility.

A firm's small size impairs its ability to obtain low premium costs due to economies of scale. That is, premiums reflect high insurance marketing and administrative costs, and small employers lack the time and skilled personnel to negotiate suitable, affordable coverage. Firms big enough to self-insure--those that assume all or part of the risk for paying claims under their health care plans--are exempt from state health insurance regulation under the Employee Retirement Income Security Act of 1974. This freedom from regulation allows self-insured firms to avoid premium taxes and the costs of state-mandated health benefits. Small businesses, which are typically unable to afford to self-insure, must therefore operate under state regulation, and must bear the associated costs.

SCOPE AND METHODOLOGY

In addition to reviewing the relevant literature and interviewing numerous state officials and experts on health insurance matters, GAO's analysis was based on a telephone survey in every state to gather information about the current status of specific small business insurance initiatives that had either been adopted or formally proposed as of September 30, 1991. Our sources for this survey were legislative liaisons in state insurance commissioners' offices and other state officials to whom we were referred. Additionally, we met with state legislative and agency officials in the following 10 states: Colorado, Connecticut, Florida, Kentucky, Maine, Massachusetts, Michigan, Ohio, Oklahoma, and Virginia.

MOST STATES HAVE SOUGHT TO IMPROVE SMALL-BUSINESS ACCESS TO HEALTH INSURANCE

We found that in response to the very substantial problems facing small businesses, nearly all states have recently adopted or proposed one or more of the following kinds of measures aimed at improving access to affordable health insurance for small firms and their employees.

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[2]Edwards, J. and others, "Small Business and the National Health Care Reform Debate," Health Affairs, vol. 11, no. 1, Spring 1992.

-- Regulations barring insurance company practices that have made insurance unavailable to many small businesses because of medical underwriting or other reasons.

-- Eliminating previously mandated benefits or offering "bare-bones" policies in order to lower costs to employers.

-- Offering direct subsidies to small businesses or tax credits for health insurance premiums as an inducement for employers to provide health insurance.

-- Risk pool programs that redistribute the high health risks of certain employees across a greater number, or pool, of employees.

This morning I will discuss these initiatives in more detail as well as some early indications of how well they are working.

Regulatory Reforms May Improve Availability of Insurance but Raise Average Premiums

States have been particularly active in the past 2 years in limiting the extent to which insurance companies can deny coverage or price high-risk firms or individuals out of the insurance market. Forty-three states have initiated one or more insurance regulatory reforms that affect the small group market. Reforms include measures to help ensure that (1) employees who want health insurance will be accepted and renewed by insurers; (2) waiting periods for coverage of pre-existing conditions will be short, will occur only once, and will be based only on recent medical history; (3) coverage will be continuous; and (4) extremes in premium costs will be narrowed to fall within ranges specified by the states.

These reforms are aimed at correcting a growing sense of unfairness in the insurance market in which individuals who change jobs or experience costly medical conditions can be excluded from coverage. However, while these reforms may improve the availability of health insurance for some, insurers may pass through the resulting costs to all beneficiaries, thereby raising the average level of premiums for others who previously had lower costs because higher cost individuals were excluded. What is still unclear is the extent of this redistribution of costs and how much more (or less) health insurance will be purchased by small businesses. More time will be needed for these state initiatives to develop fully before a conclusive assessment can be made of these issues.

The Incentive Effect of Waiving Mandated Benefits Appears to be Modest

To encourage insurance companies to design less costly insurance packages for small businesses, nearly half of the states have passed legislation reducing or eliminating health insurance coverage requirements--"mandated benefits"--and now permit insurance companies to offer lower-cost "bare bones" health insurance policies to small firms. In response, insurers in most of those states have offered plans to the small group market with premiums up to 40 percent lower than existing small group policies. In addition to excluding previously mandated benefits, these plans also often incorporate higher deductibles, preexisting condition clauses, and limit the choice of doctors that policyholders may use.

The number of additional firms induced to offer health benefits has been small, however. For example, Washington state required plans eliminating mandates and has been the state that has most increased the number of insured. Insurers sold about 1600 policies covering 2500 individuals. In general, the increase has been modest partly because elimination of mandated benefits does not yield large enough premium reductions and partly because the other policy limitations do not make these policies attractive enough for firms and their employees. This early experience with waiving mandated benefits suggests that it is not the cost of the mandated benefits that prevents small businesses from providing health benefits, but more likely the high and rising cost of all health care services.

Subsidies Have Had Limited Inducement Success

Several states have also addressed the cost issue facing small firms in the insurance market by subsidizing insurance premiums. Nineteen states have tried to use direct and indirect subsidies, including tax credits and premium tax waivers, to make it easier for employers to provide and for employees to purchase health insurance.

Few firms responded to the inducement of even substantial premium subsidies. A New York pilot program offering a 50-percent premium subsidy resulted in a 3.5 percent increase in the number of small firms offering health insurance; analysts estimate that, if the program was marketed more effectively to small business, it would increase the number of firms providing coverage by 16.5 percent. The Robert Wood Johnson Foundation's Health Care for the Uninsured Program, which piloted experiments including subsidies, small-employer pooling, and lower-cost health plans, reported that as of

November 1991, even the most successful of its nine operating programs had enrolled less than 17 percent of the small business market.

Subsidies are costly, causing most states to restrict the scope of subsidy programs in light of their current budget problems. To keep costs down, states usually limited subsidies to firms that had not previously offered health insurance. Small firms already offering such coverage felt that this placed them at a competitive disadvantage. Because of budget constraints, some states have abandoned or limited the scope of programs that require state funds. Michigan, for example, discontinued its subsidized small-employer project, and Florida and Maine limited the geographic areas in which they offer their subsidy programs.

Early evidence suggests that subsidies must be substantial (subsidies of 30 to 50 percent of premiums did not generate significant responses) before previously uninsured firms will offer insurance. Subsidies must also be shown to be more than a short-term program that could end once small firms sign up.

Pooling of Risks Helps Some Small Firms

In cooperation with insurance carriers, some states have used risk-pooling mechanisms to address the inability of small firms to spread risks across a large number of employees and their inability to exert buying power in the market for health services. These mechanisms include (1) high-risk pools for individuals who are denied health insurance or can obtain it only at prohibitive cost because of expensive medical conditions, (2) reinsurance pools to help insurers mitigate expected high losses caused by insuring high-risk enrollees, and (3) small employer pools, in which small businesses band together to purchase health insurance.

High-risk pools have made health insurance available for individual high-risk members of small employer groups. The pools enable individuals who can afford the expensive pool premiums to obtain coverage, while at the same time enabling their healthier co-workers to obtain less costly group coverage. Some states, however, prohibit this enrollee selection practice known as "carving out"; they want to avoid shifting costs from employers to the high-risk individuals and to avoid the pass-through costs small groups can incur when insurers are assessed to cover part of pool costs.

For example, California established a risk pool in 1990 and limited enrollment to 10,000 persons to keep costs within authorized limits—the limit has already been reached.

Although it is too soon to determine the level of pool losses, risk pool officials estimate that $1.10 in claims will be paid for each $1.00 paid in premiums.

Reinsurance pools help insurers accept entire small employer groups regardless of the health status of individual members, by spreading pool costs across several insurers. Experience with reinsurance pools has been limited because their adoption in Connecticut, North Carolina, and Oregon in 1991 has been so recent.

Privately sponsored and state-facilitated small-employer pools have improved affordability and access for some small firms. Their success has been somewhat tarnished, however, by a number of small-employer pools that have gone out of business or failed to pay claims, leaving groups and individuals with millions of dollars of unpaid bills. An additional problem has been a concentration of high-risk small-employer groups in pools, while low-risk groups obtain less costly insurance elsewhere.

CONCLUSIONS

The growing state commitment to improve the affordability and accessibility of health insurance for small businesses reflects recognition that employees of small firms have been poorly served by the existing market structure. Given the difficulties in reaching small firms to market new insurance policies and the introduction of most of the reforms during a recession, more time is needed to assess conclusively whether the reforms will further increase insurance coverage.

State budget problems limit the fiscal capacity of states to adopt reform measures that require substantial state subsidy or funding. As a result, states tend to focus on insurance market reforms, which generate little or no cost to the state treasury. These reforms aim at correcting a number of problems in the market, but have yet to produce significant increases in the numbers of small business employees with health insurance. Initiatives requiring state funding to subsidize the small business market are less common, tend to be limited in scope or duration, and have produced limited results. Attempts to lower the cost of insurance by waiving state mandated benefits have also yielded a modest response from employers.

These reforms do address some of the major problems in the small group market, and they have helped a number of small businesses whose owners want to offer health insurance. Ultimately, however, small business market reforms may have only a limited effect on the affordability of health insurance for most small businesses. Cost is the main barrier to coverage and continues to be under these reforms.

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Mr. Chairman, that concludes my statement. I would be happy to answer any questions at this time.