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 TO INCREASE SMALL BUSINESS PROTECTIONS

There are three approaches we can 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 business pays 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.

- o 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.

- o 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.

- o 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%, 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 choose to discontinue it.

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 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:

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

- **Employer/Individual Subsidies.** Subsidies may reduce premium payments. Firms under 5,000 pay no more than 7.9 percent of total payroll. Subsidies lower average employer payments to 68 percent of premiums. Households pay no more than 3.9 percent of income.

- **Small Business.** Small firms (under 75) 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.

- **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. To best illustrate the tradeoffs between small business protection and deficit reduction, I chose Model 1 as the base model for comparison.

As a reminder, Model 1:

- o Caps employer subsidies at 12% of each worker's individual wage, rather than 7.9% 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.

- o Caps worker payments at 3.9% of income.

- o 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 worker is $2,000.

Implications:

- o 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.

- o 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.

- Scenario A is identical to Model 1, except that the subsidies to low-wage firms with fewer than 10 employees are increased.
    - As you recall, under Model 1, firms with less than 75 employees paid only 5.5% to 12% of each worker's wages. Under Scenario A, we've gone one step further for firms under 10 with low and moderate wage workers. We've reduced the 5.5% to 2.8%. That means that the smallest, lowest-wage firm doesn't have to pay any more than 2.8% 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
Required employer prem payment per worker	$600	$300
Avg. family premium payment	$600	$600
Deficit reduction (1996-2004) relative to baseline .	$45-55	$10

Implications:

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

SCENARIO A
CHART

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

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

  - With the even larger subsidies under Scenario A, firms with fewer than 10 workers 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 looked at a firm with fewer than 10 employees with an average payroll of $18,000 to $21,000, they pay, on average, $900 per worker.

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

SCENARIO A
POTENTIAL PROBLEMS

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

- **Deficit reduction.** Providing extra subsidies to the smallest firms reduces deficit reduction.

SCENARIO B

- 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.

- 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.

	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
Required employer prem payment per worker	$600	$0
Avg. family premium payment	$600	$600
Deficit reduction (1996-2004) relative to baseline .	$45-55	$0

Implications:

- If the smallest, lowest wage employers that currently provide insurance to their workers continue to do so, they pay $200 per worker.

- If small employers that currently provide insurance to their workers discontinue coverage, they pay nothing.

- Capping an individual's payment at 3.9% of income is similar to the HSA. But for exempted workers under this scenario, the 3.9% cap applies to the total premium. Under the HSA, the 3.9% cap applies only to the 20% family share of the premium. This increases government subsidies.

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 will perceive 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 11th worker.

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

SCENARIO C

- 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.

- Family payments capped at 6% of income, instead of 3.9% as under Model 1. The cap is raised for family payments because their required contribution goes from 20% to 50%. Raising the family share to 50% and still maintaining the 3.9% 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
Required employer prem payment per worker	$600	$600
Avg. family premium payment	$600	$1,000
Deficit reduction (1996-2004) relative to baseline .	$45-55	$80

Implications:

- 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.

- Government pays less.

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

SCENARIO C
POTENTIAL PROBLEMS

- **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 will perceive that employers will choose to discontinue coverage for their workers.

- **Deficit reduction**. Government pays less because employer subsidies are dramatically reduced.

CONCLUSION

- Small businesses already receive substantial protections under Model 1.

- Since the smallest, lowest wage businesses are already protected below 50% of the premium through the subsidies, lowering the required employer share of the premium to 50% 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.

- 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.

- 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.

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 TO INCREASE SMALL BUSINESS PROTECTIONS

- Provide greater subsidies to small businesses under 10

- Exempt small businesses under 10 from employer requirement

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

PROTECTING SMALL BUSINESSES: POTENTIAL PROBLEMS

Potential problems of providing special protections to small businesses:

- **Risk of firm size gaming.** Large firms could splinter into small firms to get better subsidies.

- **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.** Health costs of employees in exempt firms would shift to non-exempt firms.

- **Maintenance of current payments.** Public fears that firms currently insuring would drop coverage under lower requirement.

- **Cliffs.** Disincentives for firms to hire workers above small business threshold.

- **Deficit reduction.** Additional protections for small firms erode savings achieved through health care reform.

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 average premium. Families pay no more than 20 percent of average plan.

- o **Employer/Individual Subsidies.** Subsidies may reduce premium payments. Firms under 5,000 pay no more than 7.9 percent of total payroll. Subsidies lower average employer payments to 68 percent of premiums. Households pay no more than 3.9 percent of income.

- o **Small Business.** Small firms (under 75) 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 FOR COMPARISON

- Caps employer subsidies at 12 percent of worker's individual wage (compared to 7.9 percent of average firm payroll 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 individual payments at 3.9 percent of income.

- Reduces firm threshold for community rating from 5,000 to 1,000 and assesses all 1,000+ firms 1 percent of payroll. All firms eligible for employer subsidies.

Model 1 Results

Avg. employer premium payment per family $2,200*

Smallest, lowest wage firms:
- Average 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

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* Employer premium payment per worker is $2,000.

SCENARIO A

- Increases subsidies to small (under 10), low wage businesses by lowering their individual wage cap by half.

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

SCENARIO A: POTENTIAL PROBLEMS

- **Firm size gaming.** Better small firm subsidies create incentives for large firms to splinter into small firms to get better subsidies.

- **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

- Firms with fewer than 10 workers are exempt from employer requirement.
- Exempt firms which voluntarily provide coverage receive same small firm subsidies in Scenario A.
- Employees in exempt firms must pay full premium, but no more than 3.9 percent of income.

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

SCENARIO B: POTENTIAL PROBLEMS

- **Firm size gaming.** Potentially greater likelihood for gaming than in Model 1 or Scenario A, as savings for exempt firms are larger.

- **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 firms of 10 or over are higher due to cost shifts from exempt firms.

- **Maintenance of current payments.** Small firms currently offering coverage may not continue to do so if exempt. Public fears such employers will drop coverage.

- **Cliffs.** Particularly problematic in this scenario, as firms adding 11th worker go from paying nothing to paying 80 percent of all employees' premiums.

- **Deficit Reduction.** Exempting small firms eliminates $45-$55 billion in deficit reduction under Model 1.

SCENARIO C

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

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

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

SCENARIO C: POTENTIAL PROBLEMS

- **Maintenance of current payments.** Small firms currently paying over 50 percent of premium may not continue to do so under lower requirement. Public fears employers will reduce coverage.

- **Cliffs.** Not as severe as Scenario B.

CONCLUSION

- Small businesses already get substantial subsidies under Model 1.
- Lowering the employer share to 50 percent does little for the smallest, lowest wage firms since they would already get substantial subsidies that effectively reduce their share below 50 percent.
- 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:
  - Supplying additional subsidies does not create the administrative and equity problems associated with an exemption for small firms, and still achieves deficit reduction.
  - Exempting small firms increases premiums to all other firms by shifting some of the health costs of exempt firms onto insuring firms. It also increases family premiums for workers in exempt firms, and eliminates deficit reduction.