

**Statement of**

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**Committee on Energy and Commerce  
Subcommittee on Oversight and Investigations  
United States House of Representatives**

**Hearing:  
The High Cost of Small Business Health Insurance:  
Limited Options, Limited Coverage**

**October 20, 2009**

Mr. Chairman and distinguished Members of the Committee:

Thank you for inviting me to share my views on the health insurance challenges facing small businesses and their workers. While I am an employee of the Urban Institute, this testimony reflects my views alone and should not be attributed to the Urban Institute, its trustees, or its funders.

Small employers are at a significant disadvantage as purchasers of health insurance relative to large employers. The consequences are clear and consistent over time: small employers are much less likely to offer health insurance coverage to their workers and workers in small firms are more likely to be uninsured. The barriers that small employers face in insurance purchasing come on multiple fronts and, as premiums continue to grow faster than wages, the declines in small employer-based coverage outpace the declines among larger employers. Without significant reforms to how small group health insurance markets function and to health insurance options that are available to those without employer offers of coverage, there should be no expectation that these negative trends will be reversed.

**Rate of Employer Offers of Coverage.** As table 1 shows, the share of employers offering health insurance varies considerably by employer size. In 2008 (the most recent data available from the Medical Expenditure Panel Survey – Insurance Component, MEPS-IC), only 35.6 percent of employers with fewer than 10 workers offered insurance to their workers, compared with 98.9 percent of employers with 1,000 or more workers.

In addition, declines in employer offers over time have been greatest among the small employers. Between 2000 and 2008, the share of employers with 100 or more workers offering coverage to their workers has remained essentially steady, whereas the share of employers with fewer than 100 workers offering coverage has fallen, with the smallest employers experiencing the largest relative declines. Employers with fewer than 10 workers were 10.1 percent less likely to offer coverage in 2008 compared to 2000, and those with 10 to 99 workers were roughly 4 percent less likely to offer coverage in 2008 than they were in 2000.

The employer size differences in the likelihood of offering coverage are even more dramatic when examining employers with a low-wage workforce separately from those with a higher-wage workforce. Among employers for which at least half of their workers were low wage,<sup>1</sup> only 18.4 percent of the smallest employers offered health insurance coverage in 2008, compared with 98.0 percent of the largest employers according to the MEPS-IC. Between 2000 and 2008, the share of low-wage employers offering coverage to their workers fell almost 28 percent for employers with fewer than 10 workers, 21 percent for employers with 10 to 24 workers, and 18 percent for employers with 25 to 99 workers, but held steady for the largest employers. Those small employers for whom a majority of workers were not low wage experienced significant declines over this time as well, but the declines were not as large as for low-wage employers (12.4 percent for the employers of fewer than 10 workers, 5 percent for those with 10 to 24 workers). So the differential in offer rates between small and large employers is large and growing even larger, and the situation for low-wage firms and their workers is particularly severe.

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<sup>1</sup> Here low wage means at or below the 25th percentile for all hourly wages.

**Rate of Take-Up of Employer Coverage, Given an Offer.** Workers in the smallest firms are also less likely than their large-firm counterparts to take up employer offers when they have one, although some of these workers receive coverage through a spouse employed by a larger firm.<sup>2</sup>

**Rate of Uninsurance.** These differences in employer offer rates and take-up translate directly into differences in insurance coverage rates for workers employed by small versus large firms. According to the Census Bureau's March Supplement to the Current Population Survey (the Annual Social and Economic Supplement)<sup>3</sup> fully one-third of workers employed in firms of fewer than 25 workers were uninsured in 2008, compared with 13.5 percent of those employed by firms of 1,000 or more workers (see table 2).

**Barriers to Small-Group Coverage.** The lower insurance offer rates among small employers are due, at least in part, to the fact that small employers must pay significantly more for the same health benefits than large employers. Smaller firms face much larger administrative costs per unit of benefit.<sup>4</sup> Administrative economies of scale occur because the costs of enrollment and other activities by plans and providers are largely fixed costs.<sup>5</sup> Insurers simply have fewer workers over which to spread these fixed costs

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<sup>2</sup> L. Clemans-Cope and B. Garrett. 2006. "Changes in Employer-Sponsored Health Insurance Sponsorship, Eligibility, and Participation: 2001 to 2005," report to the Kaiser Commission on Medicaid and the Uninsured, <http://www.kff.org/uninsured/upload/7599.pdf>

<sup>3</sup> The Henry J. Kaiser Family Foundation. 2009. "The Uninsured: A Primer," Supplemental Data Tables, available at <http://www.kff.org/uninsured/7451.cfm>.

<sup>4</sup> Congressional Research Service. 1988. *Costs and Effects of Extending Health Insurance Coverage*. Washington, DC: U.S. Government Printing Office.

<sup>5</sup> L. J. Blumberg and L. M. Nichols. 2004. "Why Are So Many Americans Uninsured?" *Health Policy and the Uninsured*, Catherine G. McLaughlin, ed. Washington, DC: Urban Institute Press.

in small firms. In addition, insurers charge higher premiums to small employers, because small employers experience greater year-to-year variability in medical expenses than do large firms<sup>6</sup> simply because there are fewer workers over which to spread risk.

Many states allow commercial insurers to adjust small employer premiums based on the health status of the workers in the group and the group's claims experience. One high-cost enrollee in a small group can have a significant impact on the average expected health spending in a small group, whereas a large group can average their high-cost cases over many people. Almost all states allow significant variations in premium rates as a function of the age of the workers, and many also allow adjustments based on the industry of the employer. These rating practices create additional difficulties for many small employers to obtain affordable coverage for their workers.

Another barrier to small employers providing health insurance is that the typical worker in a small firm is paid significantly less than workers in large firms, as shown in table 3. The median wage for workers in firms with fewer than 10 workers is about \$10,000 less than in firms of 1,000 or more workers. Economists believe that there is an implicit tradeoff between cash wages and health insurance benefits.<sup>7</sup> In other words, workers actually pay for the cost of their employers' contributions to their health insurance by receiving wages below what they would have received had no employer health insurance been offered. The lower wages of small-firm workers imply that they are far less able to

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<sup>6</sup> D. Cutler. 1994. "Market Failure in Small Group Health Insurance." Working Paper No. 4879. Cambridge, MA: National Bureau of Economic Research, Inc.

<sup>7</sup> L. J. Blumberg. 1999. "Who Pays for Employer Sponsored Health Insurance? Evidence and Policy Implications," *Health Affairs*, vol. 18.

pay for health insurance through wage reductions; consequently, their employers are less likely to offer them such benefits.

Small employers are also disadvantaged by being financially unable to devote significant resources to shopping for health insurance coverage for their workers. Doing so carefully can be an extremely time-consuming process. Small business owners do not usually have a benefits manager to take on this task and so are often left to do so themselves. Often this means relying upon an insurance broker to make choices on their behalf.. Reports of “churning,” or annual turnover of health insurance policies by small groups, are very high.

Workers in small firms that do not offer health insurance are often left with few options for health insurance coverage, and 70 percent of all uninsured workers have no access to an employer-based insurance plan (either their own or through a family member). Those that do not have a spouse with an employer offer and who are not eligible for public insurance programs have the option of pursuing coverage in the private, individual insurance market. In the vast majority of states, there is no guarantee that an individual can purchase health insurance in this market at any price. If a policy is made available, premiums in most states can be set very high as a consequence of current or prior health status, and benefit exclusions may permanently or temporarily exclude coverage for particular conditions, body parts, or body systems. Policies in this market also tend to have considerably higher cost-sharing requirements than is the case in the employer group market, as insurers perceive demand for more comprehensive policies as a signal

for high expected medical care use. As a consequence, affordable policies in this market may still pose significant medical service access limitations for modest-income workers. Plus, the administrative costs associated with these policies are the highest of any private health insurance product sold, and the lower the level of benefits, the higher is the share of the premium attributable to these administrative costs.

The challenges to small employers in providing health insurance to their workers may introduce economic inefficiencies into labor markets. First, individuals may not be choosing the job options best suited to their skills and productivity as a consequence of their preferences for health insurance coverage. For example, a worker that prefers a job in a small firm compared to one in a large firm may not take the small firm job if they or their family members have a strong preference for health insurance coverage and do not have other sources (public or private) for obtaining coverage outside of the chosen workplace. Second, individuals wishing to start their own businesses may be hampered from doing so because of the difficulty and costs associated with obtaining insurance coverage as a small business owner. These circumstances are often referred to as “job lock.” Health insurance has been shown in the empirical economics literature to have significant impacts on job choice and job mobility.<sup>8</sup> The magnitude of the efficiency implications of job lock is less clear at this time, however.

**Assistance Provided via H.R. 3200.** A number of provisions in “America’s Affordable Health Choices Act of 2009,” (H.R. 3200) would provide significant assistance related to

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<sup>8</sup> See Jonathan Gruber and Brigitte Madrian. 2004. “Health Insurance, Labor Supply and Job Mobility: A Critical Review of the Literature.” In *Health Policy and the Uninsured*, Catherine McLaughlin, ed., Urban Institute Press, Washington, DC.

health insurance coverage for small employers and their workers. The most important of these, in my opinion, are the establishment of a national health insurance exchange along with significant reforms to insurance market rating rules and the provision of subsidies to assist the low-income population purchase health insurance coverage through the exchange.

***The National Health Insurance Exchange.*** A national health insurance exchange would provide an organized marketplace for individuals and some employer groups, usually small employers, to purchase health insurance.<sup>9</sup> Under the proposal, the exchange would contract with private health insurers and offer a public health insurance option to small employers and those purchasing coverage on their own. In the first year, firms with fewer than 10 workers would be eligible to buy coverage in the exchange; this would expand to firms with up to 20 workers in the second year, and could be expanded further in later years at the discretion of the Health Choices Commissioner.

New insurance market regulations would prohibit preexisting condition exclusion periods, would limit age rating to a ratio of 2 to 1 (i.e., the oldest adult could not be charged more than twice the premium of the youngest adult for identical coverage), and would prohibit all health status rating, gender rating, and rating based upon industry of employment. In this way, the health care risks of workers in small firms would be spread more broadly than they are today in the vast majority of states, shared across all those

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<sup>9</sup> Linda J. Blumberg and Karen Pollitz. 2009. "Health Insurance Exchanges: Organizing Health Insurance Marketplaces to Promote Health Reform Goals." Urban Institute Policy Brief Series, Timely Analysis of Immediate Health Policy Issues. Available at [http://www.urban.org/UploadedPDF/411875\\_health\\_insurance\\_marketplaces.pdf](http://www.urban.org/UploadedPDF/411875_health_insurance_marketplaces.pdf)

enrolled in coverage through the insurance exchange. Not only would workers in small firms have a choice of insurance plans—a situation extremely unusual for small groups today—but those that have been priced out of the market due to health issues or an older workforce in the past may have affordable access to coverage for the first time. In addition, all small groups purchasing coverage would see a significant decrease in the year-to-year variability in premiums with this broader-based sharing of health care risk.

Small employers can also be expected to reap administrative savings from purchasing coverage through the health insurance exchange. Administrative costs are a significant component of group insurance premiums, with the Congressional Budget Office estimating that they range from 7 percent of premiums for the largest groups up to 30 percent of premiums for the smallest groups and individuals.<sup>10</sup> A significant component of administrative costs are marketing expenses. For example, insurers typically pay agent commissions of 10 percent of the first year's premium in the small-group market; first year commissions are even higher in the nongroup market.<sup>11</sup> A more organized marketplace run through the exchange, which provides greater consumer protections and improved information, could reduce marketing costs significantly. For example, the Massachusetts Connector, the exchange developed under that state's health care reform initiative, currently pays agent commissions that range from 1.3 to 3.3 percent of premiums, significantly lower than prior to reform.<sup>12</sup>

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<sup>10</sup> Congressional Budget Office. 2007. "CBO's Health Insurance Simulation Model: A Technical Description." Washington, DC: Congressional Budget Office.

<sup>11</sup> Linda Blumberg and Karen Pollitz. 2009. *op. cit.*

<sup>12</sup> "Broker Commission Schedule," presentation to Commonwealth Connector Board Meeting, March 8, 2007.

In addition, all those enrolling in insurance coverage through the proposed national health insurance exchange would have the option of remaining in the exchange, even if they change employers or leave the workforce. As a result of that consistent eligibility and the broad-based risk-pooling in the exchange, annual churning across insurance policies should be significantly reduced, which should also lead to administrative savings<sup>13</sup> as well as significantly reduce job-lock. The presence of the public plan option under H.R. 3200 would also provide small employers and their workers with an especially low administrative-cost insurance option relative to what they have today.<sup>14</sup>

***Subsidies for the Purchase of Insurance Coverage.*** Even in the presence of the national health insurance exchange and the insurance market reforms that would be implemented in conjunction with it, small employers can still be expected to be less likely to offer health insurance coverage to their workers than larger employers, and small-firm workers less likely to enroll. This is largely because the small-employer workforce tends to be significantly lower wage than those of larger employers. As a consequence, the financial assistance in purchasing exchange-based insurance coverage and the expansion of eligibility for the Medicaid program that H.R. 3200 would provide are critical elements to expanding insurance coverage for these low-wage workers and their families. Fully 60 percent of all uninsured workers have family incomes below 200 percent of the federal poverty level,<sup>15</sup> the income group for which financial assistance provided through the bill is most generous. Almost 95 percent of all uninsured workers have family incomes below

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<sup>13</sup> Blumberg and Pollitz. 2009. op. cit.

<sup>14</sup> John Holahan and Linda J. Blumberg. 2009. "Is the Public Plan Option a Necessary Part of Health Reform?" Urban Institute Policy Brief Series, Timely Analysis of Immediate Health Policy Issues. Available at [http://www.urban.org/uploadedpdf/411915\\_public\\_plan\\_option.pdf](http://www.urban.org/uploadedpdf/411915_public_plan_option.pdf).

<sup>15</sup> The Henry J. Kaiser Family Foundation. 2009. op. cit.

400 percent of the federal poverty level, and all of these workers would be eligible for some financial help in purchasing coverage through the exchange.

**Summary.** Small employers and their workers face a broad assortment of barriers to obtaining health insurance coverage today. These include high administrative costs, limited ability to spread health care risk, and a low-wage workforce. These issues have led to low rates of employer-coverage offers by small employers and high rates of uninsurance among their workers. Left to purchase coverage as individuals, the workers in small firms have few if any options for obtaining adequate, affordable insurance for themselves and their family members today. A new health insurance exchange, such as the one proposed in H.R. 3200, would spread health care risk and reduce administrative costs. The financial assistance provided under the bill to the low-income population for the purchase of exchange-based coverage and the expansion of the Medicaid program would benefit many small-firm workers. In this way, the legislation would make adequate and affordable coverage available to many more workers of small employers than is the case today.

Table 1  
Percent of private-sector establishments that offer health insurance by firm size and wage: 2000-2008

	Total	Fewer than 10	10-24 employees	25-99 employees	100-999 employees	1000+ employees
All firms						
2000	59.3%	39.6%	69.3%	84.5%	95.0%	99.2%
2008	56.4%	35.6%	66.1%	81.3%	95.4%	98.9%
Percentage Point Change:	-2.9%	-4.0%	-3.2%	-3.2%	0.4%	-0.3%
Percentage Change:	-4.9%	-10.1%	-4.6%	-3.8%	0.4%	-0.3%
Firms in which 50% or more of employees are low wage						
2000	42.5%	25.4%	46.3%	73.5%	94.2%	96.4%
2008	41.8%	18.4%	36.6%	60.1%	91.4%	98.0%
Percentage Point Change:	-0.7%	-7.0%	-9.7%	-13.4%	-2.8%	1.6%
Percentage Change:	-1.6%	-27.6%	-21.0%	-18.2%	-3.0%	1.7%
Firms in which fewer than 50% of employees are low wage						
2000	64.7%	50.2%	83.4%	92.4%	96.9%	99.4%
2008	63.8%	44.0%	79.3%	91.8%	97.6%	99.4%
Percentage Point Change:	-0.9%	-6.2%	-4.1%	-0.6%	0.7%	0.0%
Percentage Change:	-1.4%	-12.4%	-4.9%	-0.6%	0.7%	0.0%

Source: Agency for Healthcare Research and Quality, Center for Financing, Access and Cost Trends. 2000 and 2008 Medical Expenditure Panel Survey-Insurance Component.

Table 2  
Health Insurance Coverage of Workers by firm size: 2008

	self-employed	<25 employees	25-99 employees	100-499 employees	500-999 employees	1000+ employees
Employer Sponsored	46.6%	50.9%	68.4%	75.2%	77.8%	77.2%
Individually Purchased	18.8%	7.7%	4.5%	3.1%	3.5%	3.5%
Medicaid	4.3%	6.8%	5.5%	5.1%	4.5%	4.8%
Other	2.3%	1.5%	1.1%	1.0%	0.8%	1.0%
Uninsured	27.9%	33.2%	20.4%	15.5%	13.3%	13.5%
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Source: Kaiser Family Foundation. 2009. The Uninsured: A Primer. Supplemental Data Tables, available at:  
<http://www.kff.org/uninsured/7451.cfm>.

Table 3  
Annualized Median Wage  
by Firm Size, 2008

Firm Size	Median Wage
All Firm Sizes	\$33,000
Under 10	\$27,733
10-24	\$28,000
25-99	\$31,000
100-999	\$35,000
1000+	\$37,333

Source: Urban Institute tabulations of the .  
2009 Annual Social and Economic Supplement  
to the CPS.