IBDeditorials.com

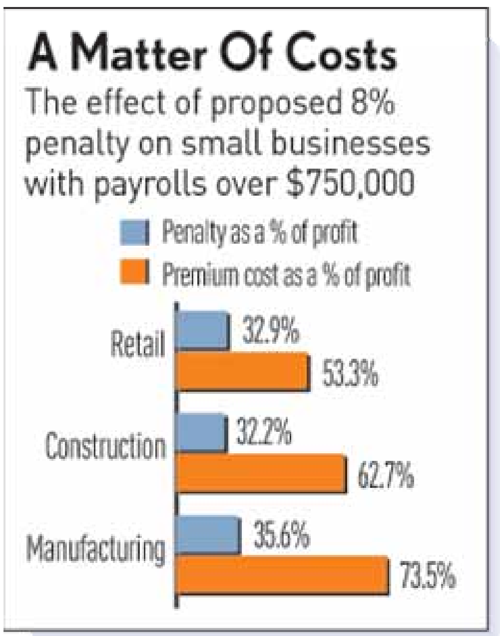
Proposed Health Insurance Fine Puts Small Businesses In A Fix

By PETER BENESH
News Analysis by IBD | Posted Thursday, August 06, 2009

Like just about every other sector of the economy, small business has been trying to get a fix on a moving target: the Democratic Congress' notion of how to pay for the health insurance it wants all Americans to have.

The House version would require any employer with a payroll of at least $500,000 a year to provide health insurance or pay a penalty.

The penalty would start at 2% of payroll and increase with payroll size. The maximum penalty would be 8% of payroll for firms whose annual outlay for wages and salaries is $750,000 or more.



Experts say even that maximum penalty of 8% of payroll could be such a good deal for employers that they'd rather pay it than buy health insurance for their workers. That would put those workers into a government-run plan.

In fact, paying the penalty will be far cheaper than buying coverage, according to data compiled by Sageworks, a data analysis firm focused on small business.

As a percentage of profits, the penalty would cost most small businesses half what they'd pay for health insurance premiums, Sageworks found.

For companies not yet offering employee health benefits, the penalty would be the likely choice over insurance premiums, says Brian Hamilton, Sageworks' CEO.

Looking at a retail business with a $750,000 payroll, Sageworks calculates the 8% penalty would cost 32.9% of profits. Insurance premiums would cost 53.31% of profits.

For a construction firm, the penalty would equal 32.2% of profits, while insurance premiums would cost 62.7%.

A manufacturing firm in the same bracket would spend 35.6% of profits on the penalty and 73.5% on insurance premiums, Sageworks calculates.

"In the short run, many small businesses will pay more money," Hamilton said.

If the payroll exceeds $500,000, paying the penalty will be a new, added cost of doing business. Small businesses spend 60 cents to 80 cents of every revenue dollar on salaries, Hamilton says.

The uninsured penalty will add up to 8% of the payroll cost. That could dampen new hiring.

Even if a company wants to add workers because its business is growing, it might not be worth it if doing so pushes the payroll to the next level, where a higher health benefit penalty would apply.

For that and other reasons, making health insurance decisions won't be easy. The legislation would force small businesses to make complex decisions based on what may be arbitrary or vague criteria. That's because the government will set the standard for what constitutes an acceptable level of health insurance.

The small-business owner who has already been providing benefits will have to figure out if the firm's insurance plan meets the government standard, says Bill Rys, tax counsel for the National Federation of Independent Business.

The proposed legislation would penalize an employer whose health plan doesn't fit the government's idea of qualified coverage.

Upgrading to a better plan would be more expensive. The owner must decide if he can afford it, or whether to pay the penalty and provide no health benefits.

Small-business owners already have enough difficulty shopping for insurance, Rys says. There's nothing in the draft legislation to suggest that insurance will become easier to purchase, or less costly.

"My hunch is that what will be mandated will be more expensive than what insurers are currently offering," Rys said.

Employers also will be expected to offer family benefits. Most small businesses now offer benefits for the worker alone.

A proposed tax credit for small businesses that do provide health benefits might help with the cost burden, Rys says. But the deliberations thus far base the credit on the average wage per employee. That opens up questions of regional differences in business, labor and living costs.

It raises another question, Rys says. If a small-business owner wants to hire someone at a higher pay scale, he'll have to consider how that will affect the tax credit he would get for providing health benefits to his whole work force.

It might be a disincentive for the employer to give workers raises.

Still, if the new plan can decrease health care coverage costs for small business, it might be a winner, Hamilton says. But he voices doubt that it will reduce costs.

Michael Cannon, director of health policy studies at the Cato Institute, says the penalties might be smaller than health insurance premiums. But that doesn't mean employers can cut labor costs by dropping coverage and paying the fines.

The level of overall compensation is dictated by supply and demand in the labor market.

Suppose supply and demand results in a market-clearing wage of $50,000 a year. If a company's workers want employer-sponsored insurance — which costs $10,000 per worker — then the firm will provide it and reduce cash wages to $40,000 a year, Cannon says.

Then suppose the government imposes a $5,000 per-worker penalty on companies that don't provide coverage. The firm could drop its coverage and pay the penalty, saving $5,000. But it would have to increase cash wages by $5,000 to bring its total compensation package up to the market-clearing level of $50,000 a year. "Otherwise, the firm's workers will flee to firms that offer higher compensation packages," Cannon said.

The Obama administration figures the final reforms will offer enough incentives to convince small businesses to buy insurance in a more competitive market.

All the plans under consideration offer tax credits for small businesses that buy insurance for employees. They also propose an insurance exchange where small businesses would find more price competition among insurance vendors.

Where there isn't enough competition to bring down prices, the publicly run insurance company the administration proposes will provide it, said Christina Romer, head of the Council of Economic Advisers.

Meanwhile, small businesses face competitive pressures of their own — specifically, competing for workers with larger businesses that offer health benefits.

"Small-business owners want to provide health insurance," Romer said, during a July 29 Webcast.

In Massachusetts, a mandated plan includes a $295-per-worker annual penalty paid by employers that don't offer health benefits.

The number of small-business employers that do offer insurance rose from 88% to 92% from 2007 to 2008, says Shanna Shulman, director of policy and research at the Blue Cross and Blue Shield of Massachusetts Foundation.

For managed care companies, the risk of small businesses canceling policies has already been felt, says Jason Gurda, health insurance analyst with Leerink Swann. "They've had that pressure for a couple of years."

Among large managed care firms, WellPoint and Coventry Health Care tend to have more policies covering small businesses.

If more small businesses opt out of insurance, the damage could be offset by uninsured individuals seeking coverage in the private market, Gurda says.

Small businesses will opt out of private insurance and into pay-to-play if doing so is cheaper and employees are not harmed, says Les Funtleyder, health sector analyst with Miller Tabak.

"People dumped on the public option will mean a revenue loss to insurers," he said.

But he added that if the exchange works, those individuals would buy coverage from private firms.