SMALL BUSINESS MAJORITY

The Economic Impact of Healthcare Reform on Small Business

June 11, 2009

Small Business Majority

Small Business Majority is a national nonprofit nonpartisan organization, founded and run by small business owners, that brings the voice of America's 27 million small businesses to the public policy table. We are focused on solving the single biggest problem facing small businesses today: the skyrocketing cost of healthcare. We use scientific research to understand and represent the interests and needs of all small businesses, from sole proprietors to 100-person companies.

Executive Summary

Introduction

More than any other sector of the economy, small business suffers from our broken healthcare system. From spiraling premium costs to inadequate access to quality healthcare for themselves and their employees, small business owners have seen their prospects for growth diminished and their profits slashed by today's patchwork of inefficient healthcare options.

As the nation now debates comprehensive healthcare reform, America's entrepreneurs understand the need to focus on practical and effective solutions. For most of them, the tired political demagoguery of past healthcare debates cannot be allowed to trump the need for wholesale change. The cost of doing nothing is simply too high.

Against this backdrop of a failing system and the prospect of true reform, Small Business Majority commissioned noted economist and Massachusetts Institute of Technology professor Jonathan Gruber to apply his trusted healthcare economics microsimulation model to the small business sector—specifically those businesses with 100 or fewer employees. Using his model, Dr. Gruber analyzed the continued impact of no reform on small business costs, jobs, wages and profits over the next ten years and contrasted that with three different reform scenarios, all based on the shared responsibility model proposed by President Obama and now being debated on Capitol Hill.

This study represents the first ever application of the Gruber Microsimulation Model (GMSIM) to a broad range of small business success benchmarks under health reform. The results are clear: Small businesses will be far better off under a thoughtfully reformed healthcare system based on shared responsibility among individuals, business, government and the healthcare industry—as long as such a system includes provisions that reflect the particular financial constraints faced by small businesses. Under the models considered, shared responsibility includes tax credits to enable small business owners to better afford coverage options (based on the size of the business), coupled with a payment, on a sliding scale, to be made by employers who don't offer health insurance (also based on the size of the business).

The analysis demonstrates that the type of healthcare reform that is emerging from today's debate will save small businesses hundreds of billions of dollars in costs, protect small business wages and jobs—and allow small business owners to continue to reinvest in and grow our economy.

Key findings

The study compares three healthcare reform scenarios with each other and contrasts them with a continuation of the existing system. The reform options analyzed all include a financing system of shared responsibility. Three scenarios were considered, with a sliding scale of tax credits to be provided to employers who offer insurance, and a sliding scale of payments from employers who don't. The three scenarios can be characterized as providing **limited** support for small employers, **expanded** support for small employers, or **significant** support that would protect small business owners (see pages 5-6).

For each of the scenarios, the effects on four benchmarks of small business success are examined: (1) costs, (2) jobs, (3) wages and (4) profits, while also analyzing the effect on "job lock" (the concept that workers stay in jobs longer than they would like because they can't replicate the benefits the jobs provide). The report shows that, in just about every case, reform would likely reduce costs, save jobs, preserve wages, bolster profits and virtually eliminate "job lock" when compared to doing nothing.

Specifically, the study shows that over the next ten years the three reform scenarios considered would:

- ***Dramatically reduce the costs small businesses pay to provide health insurance to their employees.*** Healthcare costs are growing faster than the overall economy. Without reform, small businesses will pay nearly $2.4 trillion dollars over the next ten years in healthcare costs for their workers. With reform, the study shows that small businesses can save as much as $855 billion, a reduction of 36 percent, money that can be reinvested to grow the economy (see page 9).

- ***Save small business jobs.*** Healthcare costs are rising so quickly that there is no way to prevent some job loss due to those costs. Without reform, the study shows that 178,000 small business jobs will be lost in 2018 as a result of healthcare costs. Depending on the particular mechanism used to help small businesses meet their healthcare obligations, healthcare reform can save up to 128,000 of these jobs, reducing job losses by as much as 72 percent (see page 11).

- ***Preserve wages for small business employees.*** As healthcare costs rise, businesses pass those costs on to their workers, which usually results in lower wages or stagnant wage growth. Without healthcare reform, the study shows that $834 billion in small business wages will be lost due to high healthcare costs over the next ten years. Reforming healthcare, and providing support to small businesses under a new system of shared responsibility, can save workers up to $309 billion in wages over the next ten years (see page 14).

- ***Bolster small business profits and competitiveness.*** Rapidly rising healthcare costs also weaken the economic market. Without reform, small businesses will continue to spend more and more on healthcare, limiting their ability to reinvest in their businesses and start new ventures. Over the next ten years, the study shows that small businesses will lose $52.1 billion in profits to high healthcare costs. Healthcare reform can reduce these losses by more than 56 percent, saving $29.2 billion in small business profits and allowing small business owners to reinvest those dollars in the economy (see page 17).

- ***Ease, and likely eliminate, "job lock."*** Today, many workers with health insurance are "locked" in their jobs because they worry they can't find a job with comparable benefits. The analysis shows that 1.6 million small business workers suffer "job lock"—roughly one in 16 people currently insured by their small business employers. Healthcare reform will ensure that individuals and families can purchase the coverage they need at an affordable rate, likely bringing the new rate of job lock close to zero. This change will remove a major barrier to people who want to become entrepreneurs or join thriving small businesses (see page 17).

Conclusion

Small businesses in the United States are suffering great harm under our current healthcare system and will likely fare far better under a substantially reformed system along the lines of what is currently being debated in Washington—as long as such a system offers appropriate levels of assistance to small businesses in meeting their healthcare obligations.

Background

The current system

In a system where approximately 61 percent of Americans get their health insurance through an employer[1]—either their own or a family member's—businesses are bearing the burden of rising healthcare costs. In the competitive global market, employers cannot pass costs on to consumers, and as healthcare costs continue to rise faster than wages or productivity, workers can't bear them completely either.[2] Overall, employers in the U.S. spend an average of 11.3 percent of payroll costs on health benefits to insure their employees, compared to just 4 percent in Japan and 2 percent in the United Kingdom.[3]

Small businesses, due to their size, face a disadvantage in the health insurance market, which means they often pay more, and get less. A survey of small businesses showed that the fewer employees a small business has, the higher its premium rates.[4] At the same time, cost sharing tends to be higher for employees of small businesses than for those of large businesses, leaving them at greater financial risk in the event of an illness.[5] Overall, small businesses and their employees pay an average of 18 percent more for the same level of health insurance benefits as large businesses.[6] The costs of coverage are unnecessarily, and often disproportionately, higher for small businesses. Primary causes of this cost discrepancy include:

- ***Cost shifting.*** Like all the privately insured, small businesses bear the costs of care for the uninsured. Estimates of this cost shift suggest that anywhere from 2 to 11 percent of private health insurance premiums go to cover uncompensated care costs incurred by providers.[7] The most recent study suggested that 8 percent of the average 2009 health insurance premium, or approximately $1,100 per family, is this hidden cost shift.[8]

- ***Administrative costs.*** Insurance costs for small businesses are further exacerbated by the higher administrative costs they face. The Congressional Budget Office has estimated that administrative costs range from 27 percent of premiums for very small businesses to 9 percent for businesses with at least 100 employees.[9] These costs are generated not just by marketing and paperwork costs associated with billing and other activities, but also by underwriting—the process insurers are sometimes allowed to use to determine how much to charge small businesses based on past medical expenses.

The result is that smaller firms are much less likely to offer health insurance than larger firms. Just 49 percent of firms with 3-9 employees offer coverage, compared to 95 percent of firms with 50 or more employees.[10] Without coverage through their employer, small business employees must find coverage on their own. Often, they must turn to the individual market where coverage is more expensive for older, sicker Americans—if it is available at all. One survey found that as many as 89 percent of those seeking coverage in the individual market give up before obtaining it, either because they were not offered coverage or the coverage they were offered was unaffordable.[11]

Current reform discussion

For the first time in 15 years, national policymakers are engaged in a serious debate over how to comprehensively reform the healthcare system. The importance of the issue can be seen in the release of the health plans in 2008 by both the Republican and Democratic candidates for president. A number of members of Congress have also developed proposals and reform options, including the Senate Finance Committee bipartisan effort between Chairman Max Baucus (D-MT) and Ranking Member Charles Grassley (R-IA).

National policymakers are forming a consensus around an approach to healthcare reform known as "shared responsibility," under which individuals, business, government and the healthcare industry all play a role in providing affordable, high-quality coverage for all. The healthcare debate this year has been framed primarily by the following:

- ***President Obama's campaign plan:***[12] The plan outlined by President Obama during the campaign proposes to ensure affordable, high-quality coverage for all by making access for individuals easier through insurance exchanges. The president's plan also includes a number of aggressive cost containment measures, including expanding the use of health information technology, promoting prevention and cost-effective care, as well as increasing competition in the healthcare marketplace. Reforming payment practices and allowing drug price negotiations would also reduce costs in the Medicaid and Medicare programs.

  Recognizing the "unique challenges"[13] small businesses face in the healthcare system, the Obama plan includes several provisions targeted at small business. Although the plan calls for employers to share responsibility by offering insurance or contributing toward the cost of their employees' coverage, some small businesses would be exempt. Tax credits would be provided to help those small businesses that do offer coverage. The federal government would reinsure catastrophic costs to reduce the volatility in insurance costs small businesses often face.

- ***Senator Baucus's white paper:***[14] Like the Obama plan, the Baucus plan calls for an insurance exchange to facilitate access to coverage, including measures to make coverage more affordable for individuals and small businesses. Unlike the Obama campaign plan, the Baucus plan calls for an individual mandate, or requirement for individuals to purchase coverage. Senator Baucus would contain costs by "improving healthcare quality and value," including focusing on preventive and primary care, reforming the delivery and payment systems and addressing waste in the system.

  Senator Baucus has long championed efforts to help small businesses navigate the healthcare system, including previous legislative efforts to provide tax incentives and help pool small employers. The white paper includes shared responsibility for employers to offer coverage, but like Obama would exempt the smallest of firms.

- ***Senate Finance Committee policy options:*** Recently released bipartisan reform proposal options from the Senate Finance Committee specifically recommend providing a tax credit equal to 50 percent of the employer's share of insurance premiums for small businesses with 10 or fewer employees with average annual wages below $20,000. This credit would phase out for businesses with between 10 and 25 employees earning average annual wages of up to $40,000. The Committee's proposal on shared responsibility for employers would require employers with more than $500,000 in total payroll to offer health insurance to their employees and cover 50 percent of premium costs, or pay an assessment. The assessment would either be a flat fee per employee, or a percent of payroll, each of which would increase for employers with higher payroll.

While a number of other national policymakers and stakeholders have also offered healthcare reform proposals, they are unlikely to serve as models for a final reform bill and thus were not considered for the analysis by Dr. Gruber. Despite this, nearly every reform proposal acknowledges the importance of small business in healthcare reform—and the need for special protections to support small businesses.

The Study

On behalf of Small Business Majority, Dr. Gruber analyzed several reform scenarios based on the shared responsibility model. These scenarios are based primarily on the general reform structure proposed by President Obama, as the President and Congress continue working on the details. These details—particularly the size of the tax credits to help with the purchase of insurance—are important in determining the expected effects on small business. The study modeled three different scenarios to show how the specific structure of healthcare reform can have a range of impacts on small businesses as they participate in the new system. (The specific methodology used in the report is discussed in the appendix.)

The simulation model presumes that small businesses make a series of hard choices in the face of escalating healthcare costs. Employers usually include increased health benefit costs in workers' total compensation packages, which can limit wage growth or reduce wages.* If costs are still too high, businesses will cut back on employment in order to continue providing health benefits to their workers. Any remaining healthcare costs will come out of small businesses' profits, limiting their ability to reinvest in and grow their business and, in turn, the nation's economy.

Baseline scenario: no healthcare reform

In the baseline scenario, we assume that the current fragmented healthcare system continues, and assess the impact of growing healthcare costs on small businesses. We assume an annual inflation rate of 9 percent, based on Kaiser Family Foundation historical data showing small business premiums between 1999 and 2007 grew faster than most conventional healthcare cost growth rates assume.[15] Small business premiums also grew faster than premiums for larger businesses.

* Every model shows non-shifted health care costs as a very small percentage of total revenues or profits, which indicates the extent to which businesses are able to pass those costs on to workers. For more information, see the appendix.

Reform scenarios

The reform scenarios in this analysis share a basic structure in terms of areas of change within the healthcare system, and differ only in some of the reforms targeted at small business. While the precise details of the reforms national policymakers will pursue haven't yet been finalized, the models analyzed here include the following elements under discussion at the national level:

- ***Guaranteed access to coverage:*** Every American will be able to purchase coverage through an insurance exchange, regardless of their health status. This will mean small business employees will no longer have to consider whether they will still have access to affordable health coverage if they take a new job, or decide to become an entrepreneur and start their own small business.

- ***Public program expansions.*** Every American with an income below the federal poverty level (FPL) will have access to Medicaid.

- ***Premium assistance for families.*** Health insurance will become more affordable as all families with incomes below 400 percent of the FPL will have access to subsidized insurance.

- ***Children's mandate.*** Parents will be required to ensure that their children have health coverage.

- ***Auto-enrollment into employer-sponsored insurance (ESI).*** Those who are offered ESI will be automatically enrolled.

- ***Cost containment.*** The analysis assumes that cost containment steps will limit cost growth to 4 percent in the first year and 8 percent per year thereafter. This reflects the assumption that many initial reforms will lower healthcare costs significantly and immediately, but that they will be one-time savings, which will have a lesser effect on lowering the annual growth in healthcare costs. This assumption is consistent with other models of the impact of national healthcare reform on healthcare costs.[16]

The models structure shared responsibility for small businesses in two key ways. The first is in the payments to be made by employers that do not offer health insurance. Of those businesses that continue not to offer coverage, the smallest ones will pay less than larger ones; our scenarios consider sliding scales based on both number of employees and size of payroll.

To reflect the bipartisan desire to support small businesses in sharing the responsibility for the new health coverage system, each model also includes a version of targeted tax credits to support businesses that do offer coverage. This support is based on the number of employees at a firm, and employee earnings. The proposed tax credits reflect what firms are actually spending on health coverage for employees, and so keep pace with healthcare inflation. None of these reform scenarios were intentionally based on any specific reform proposals put forward by policymakers.

The three scenarios modeled are as follows; Table 1 shows the key differences.

- ***Reform scenario one:*** *Limited small employer support.* The shared responsibility requirement for firms not offering coverage begins at 2 percent of payroll for firms with payroll of less than $100,000, and steps up to 6.5 percent of payroll for firms with total payroll of greater than $250,000. A targeted tax credit of 50 percent of health costs is available for businesses with fewer than 25 employees who earn less than $40,000 per year.

- ***Reform scenario two: Expanded small employer support.*** The shared responsibility requirement starts at just 1 percent of payroll for all firms with less than $250,000 total payroll. The minimum contribution increases more slowly than under the Limited scenario, and only firms with payroll exceeding $15 million contribute the full 6.5 percent. The tax credit stream is also richer, providing 50 percent of the employer's share of healthcare costs for firms with up to 50 employees. The tax credit phases out for firms with employees earning between $50,000 and $100,000.

- ***Reform scenario three: Significant small business support.*** Tax credit levels are now based on number of employees, and the smallest firms—those with fewer than 11 employees—are not required to pay for health insurance. The payment to be made by non-offering firms increases from 2 percent of payroll to 6.5 percent of payroll for firms with 50 or more employees. The tax credit is the same as in the Expanded scenario.

Table 1: Reform Scenarios Compared

	Baseline: No Change to Current System	**Reform Scenario 1: Limited Small Employer Support**	**Reform Scenario 2: Expanded Small Employer Support**	**Reform Scenario 3: Significant Small Employer Support**
Cost Containment	None: 9% annual inflation	4% inflation first year, 8% subsequently	Same	Same
Shared Responsibility		■ 2% for firms with payroll <100K ■ 4% for firms with total payroll >100K & <250K ■ 6.5% for firms with payroll >250K	■ 1% for firms with payroll <250K ■ 4% for firms with total payroll >250K & <1M ■ 6% for firms with total payroll >1M & <15M ■ 6.5% for firms with payroll >15M	■ 0% for firms with <11 employees ■ 2% for firms with 11-34 employees ■ 4% for firms with 35-49 employees ■ 6.5% for firms with >= 50 employees
Small Business Tax Credit		50% of employer share for firms with <25 employees who earn less than 40K per year	50% of employer share for firms with <50 employees phased out for employees who earn between 50K and 100K	50% of employer share for firms with <50 employees phased out for employees who earn between 50K and 100K

Detailed Findings

Comprehensive healthcare reform based on a system of shared responsibility will reduce the cost to small businesses of providing health insurance to their employees

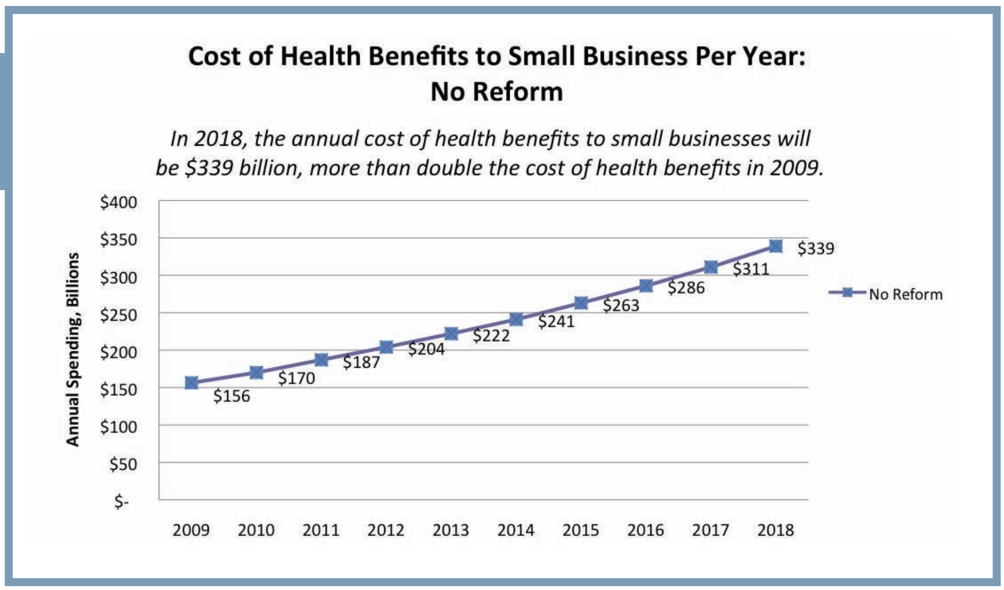
The cost of employer-sponsored health insurance is an ever-larger burden for businesses. In 2007, private businesses of all sizes spent approximately $480 billion on health insurance for their employees and their employees' families.[17] This employer spending made up approximately 23 percent of total U.S. healthcare spending on services and supplies.[18] Small business owners share in that cost burden.

Small business owners respond to these costs in a number of ways. In the following sections, we show the impact of healthcare reform on unemployment and lost wages and profits small businesses sustain due to high healthcare costs. In this section, we analyze the impact of reform on the total costs faced by small business owners.

Impact of continuing the current system

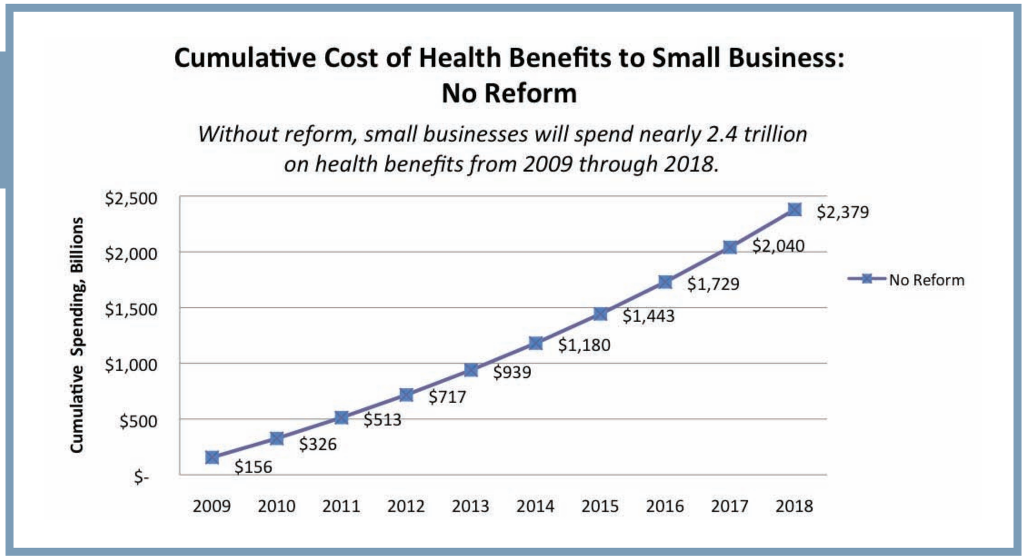
In the current system, our model estimates that small business owners will spend $156 billion on employee health insurance benefits in 2009. From there, small businesses' annual spending on healthcare will more than double over ten years to $339 billion per year in 2018, as shown in Chart 1. The annual growth in these healthcare costs will also double. Health costs for small businesses increase by $14 billion between 2009 and 2010, but will increase by $28 billion between 2017 and 2018.

Chart 1



The cumulative impact of the current system on small business health costs is even greater. If the current system is allowed to continue, small business will spend nearly $2.4 trillion on health insurance benefits for their workers from 2009 through 2018, as shown in Chart 2.

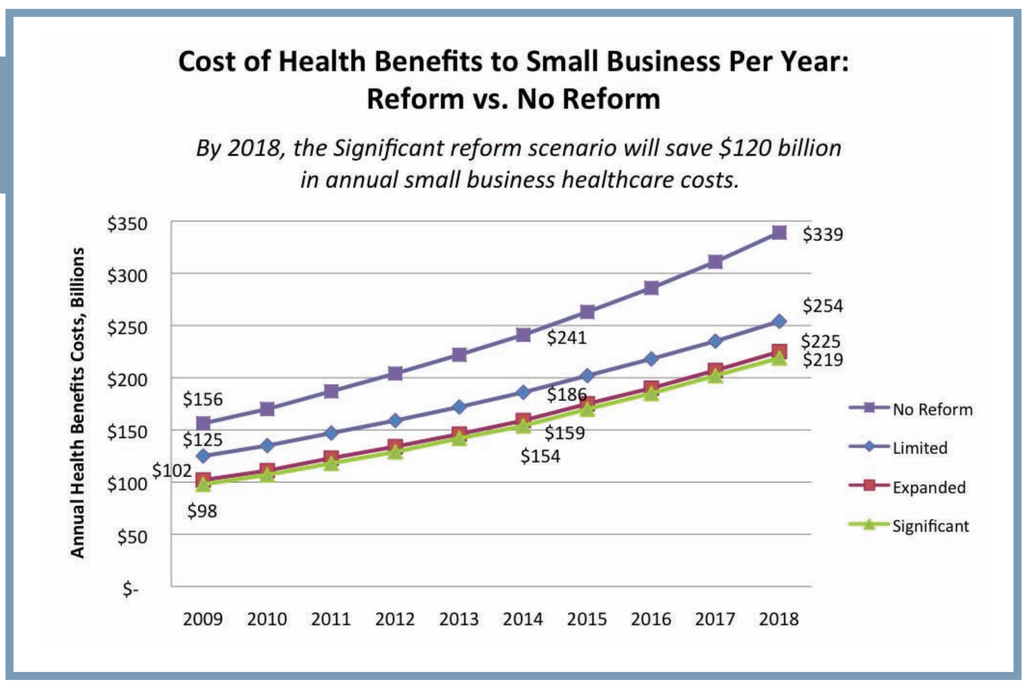
Chart 2



Annual impact of healthcare reform

Healthcare reform has the potential to significantly decrease the burden of healthcare costs for small business owners, as shown in Chart 3. The savings are immediate under each of the reform scenarios modeled, but the Expanded and Significant reform scenarios, which offer greater support to small businesses, will reduce costs more than the Limited reform scenario. In the first year of reform, small businesses will spend just $125 billion on health benefits, a 20 percent savings from the current system. By 2018, small businesses will save 25 percent under the Limited reform scenario compared to the current system. The Expanded and Significant reform scenarios will save small businesses between 34 and 37 percent per year relative to the current system.

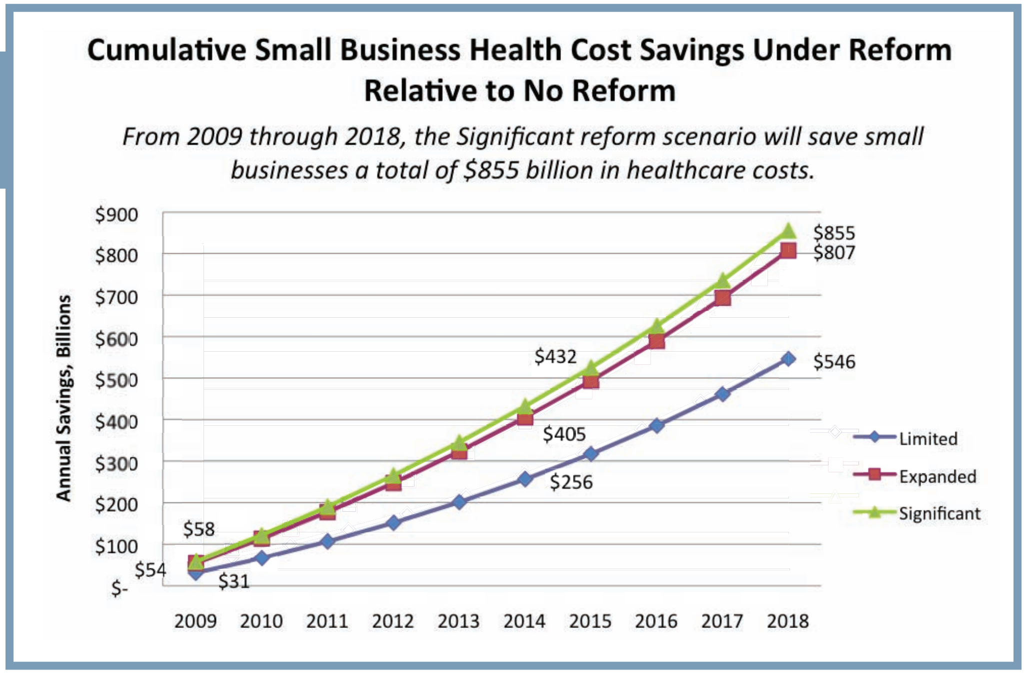
Chart 3



Cumulative impact of healthcare reform

Our analysis shows that healthcare reform will produce significant healthcare cost savings for small businesses over the next ten years. Relative to continuing the current system, the Limited reform scenario starts saving small business $31 billion in 2009, and savings total $546 billion for the entire ten-year period, as shown in Chart 4. The other scenarios produce even bigger savings. Expanded scenario savings start at $54 billion in 2009, and total $807 billion for the entire ten-year period. The savings under the Significant scenario are slightly higher, starting at $58 billion in 2009 and totaling $855 billion for the entire period.

Chart 4



Healthcare reform will save jobs

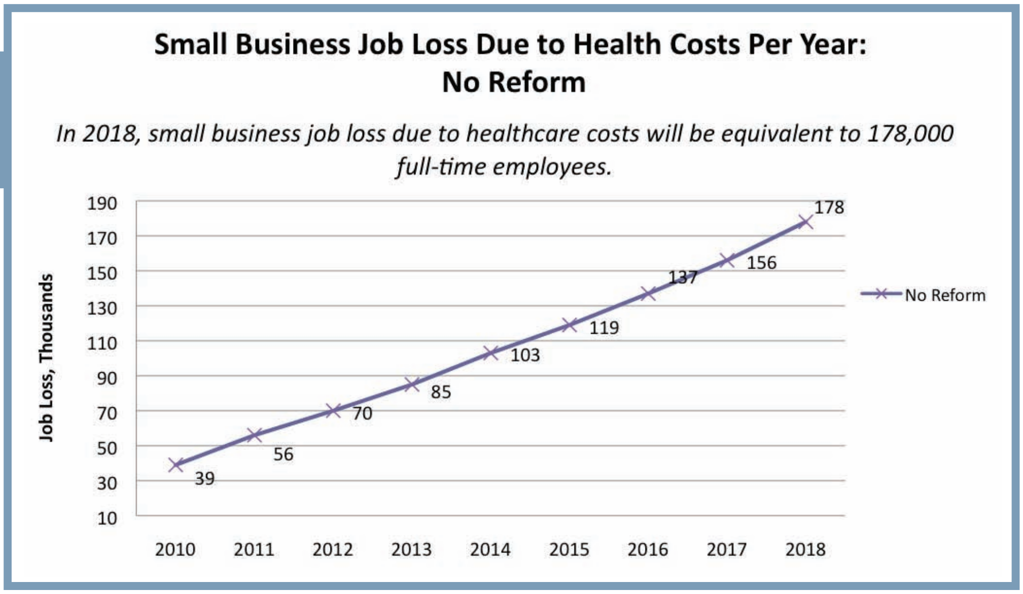
Nearly 59 million Americans work for a small business in 2009.[19] In managing health costs, small businesses sometimes have no choice but to cut jobs to save health benefits for their remaining employees. Protecting small business jobs will be a critical piece of healthcare reform, particularly in helping get the economy back on track. Healthcare reform that helps more Americans afford insurance and that slows the growth of health costs can reduce unemployment by hundreds of thousands of those jobs—even when all businesses are required to share responsibility.

Unlike the other sections of this paper, it is not possible to quantify the cumulative impact of health costs on small business job loss. This is because job loss is a "stock"—that is, it can only be measured at a point of time. As such, it is the number of full-time-equivalent employees who lose their jobs in that year, not the number who lose their jobs that year compared to last year due to healthcare costs. The other measures in this paper, such as costs and wages, are a "flow," which means they can, and should, be measured over a unit of time.

Impact of continuing the current system

If the high rate of health cost inflation under the current healthcare system continues, tens of thousands of small business workers will lose their jobs. The model estimates that these high healthcare costs will lead to 178,000 fewer small business workers in 2018, as shown in Chart 5.

Chart 5

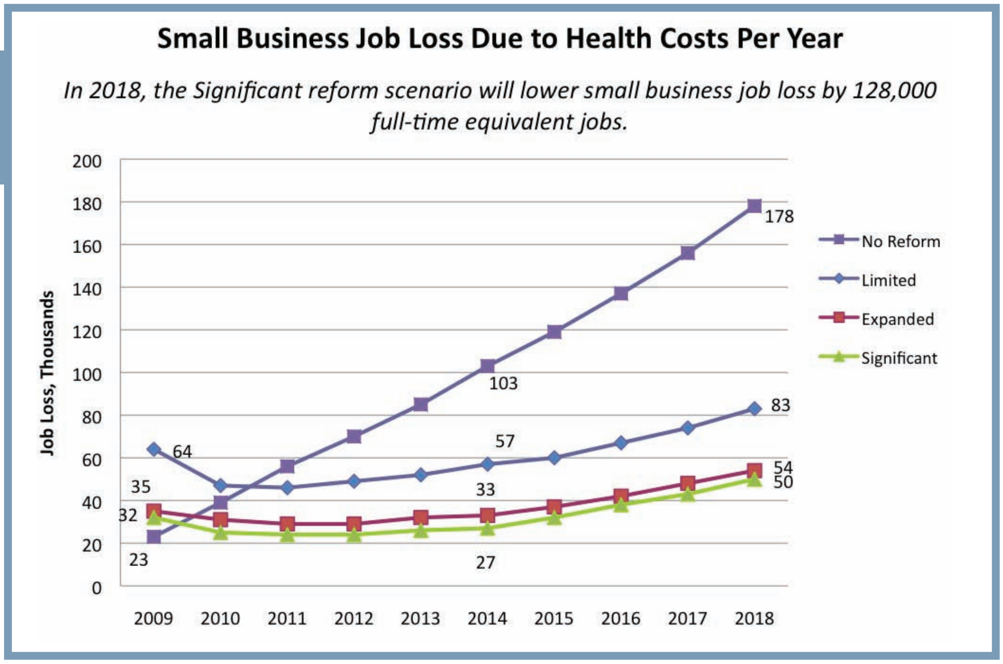


Annual impact of healthcare reform

Over the next ten years, failure to reform the healthcare system and stop healthcare costs from continuing to grow will result in rising small business job losses. How quickly healthcare reform is able to lower job loss —and how much healthcare reform is able to reduce job losses relative to the current system—depends on how much support reform offers small businesses. All three reform scenarios improve the job market substantially over the ten-year period, both lowering job losses and slowing the rate of loss.

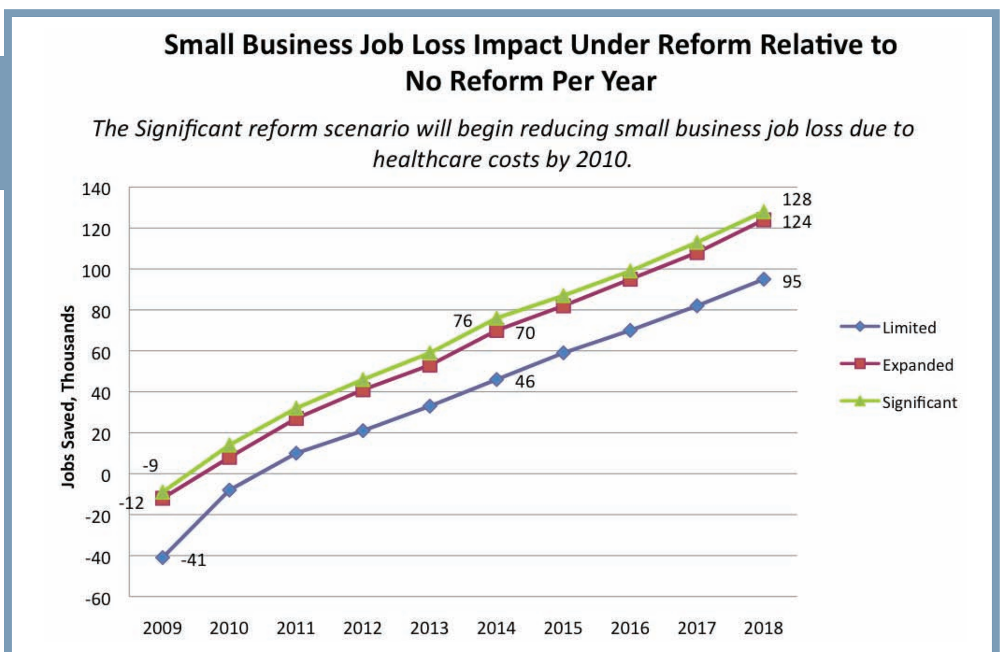
As Chart 6 shows, continuing the current system will lead to significant job loss compared to the reform scenarios. The Expanded and Significant reform scenarios reduce job losses by 70 and 72 percent, respectively, compared to the scenario of no reform, and even the Limited reform scenario cuts unemployment by more than half, saving 53 percent of jobs otherwise lost due to health costs.

Chart 6



According to the Gruber analysis, job loss will be higher in the early transition period under reform than under the current system. For two of the three scenarios, this trend reverses by the second year, as fewer workers lose their jobs due to health costs under reform than under a continuation of the current system. Chart 7 shows year-by-year job savings under reform as compared to doing nothing. The Limited reform scenario, which requires the most from small businesses, begins reducing job loss in year three of reform, and in 2018 will reduce job losses by 95,000 full-time equivalent jobs otherwise lost due to high healthcare costs. The Expanded scenario, which provides larger tax credits and lower employer contribution requirements, begins reducing job loss over baseline in year two, and in 2018 will reduce job losses by 124,000 full-time equivalent jobs otherwise lost under the current system. Finally, the Significant scenario also begins reducing job loss in year two, and reduces job losses by 128,000 full-time equivalent jobs otherwise lost under the current system.

Chart 7



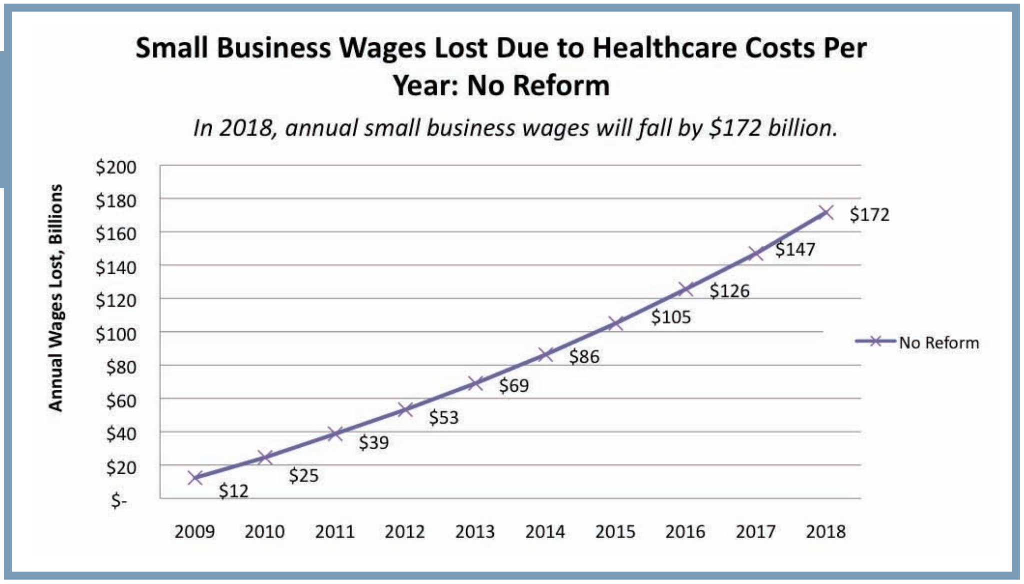
Healthcare reform will save wages for small business employees

Wages for American workers have not kept pace with inflation in the economy—let alone with the rising costs of healthcare.[20] As noted above, small businesses are facing an even higher annual increase in health costs than larger businesses. This reduced growth in wages is due in part to the rise in health insurance costs, as employers pass those costs on to workers in the form of lower wages. Although total compensation for workers is holding steady as a share of Gross Domestic Product, rising healthcare costs are reducing their take-home pay.[21] Dr. Gruber's model estimates that small business workers' earnings will total more than $2.3 trillion dollars in 2009. Slowing the growth of healthcare costs is necessary to protect these and future earnings for small business workers.

Impact of continuing the current system

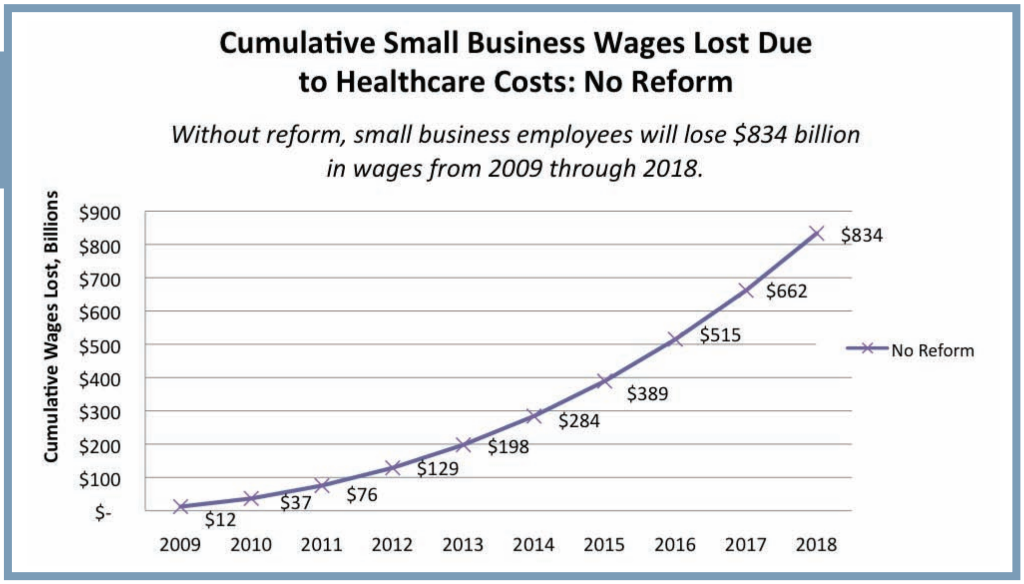
If our current healthcare system continues, small business workers will see wages fall by increasingly higher amounts due to healthcare costs. In 2009, annual wages for all small business employees are expected to fall by $12 billion, and by 2018, annual wages will fall by $172 billion—or 14 times as much, as shown in Chart 8. The annual increase in wages lost will more than double over the next ten years. Between 2009 and 2010, the increase in wages lost will be $12 billion, but between 2017 and 2018, that figure will be $25 billion.

Chart 8



The cumulative impact of the current system on small business wages is even greater. If the current system is allowed to continue, from 2009 through 2018, small business wages will be reduced by $834 billion due to high healthcare costs, as shown in Chart 9.

Chart 9

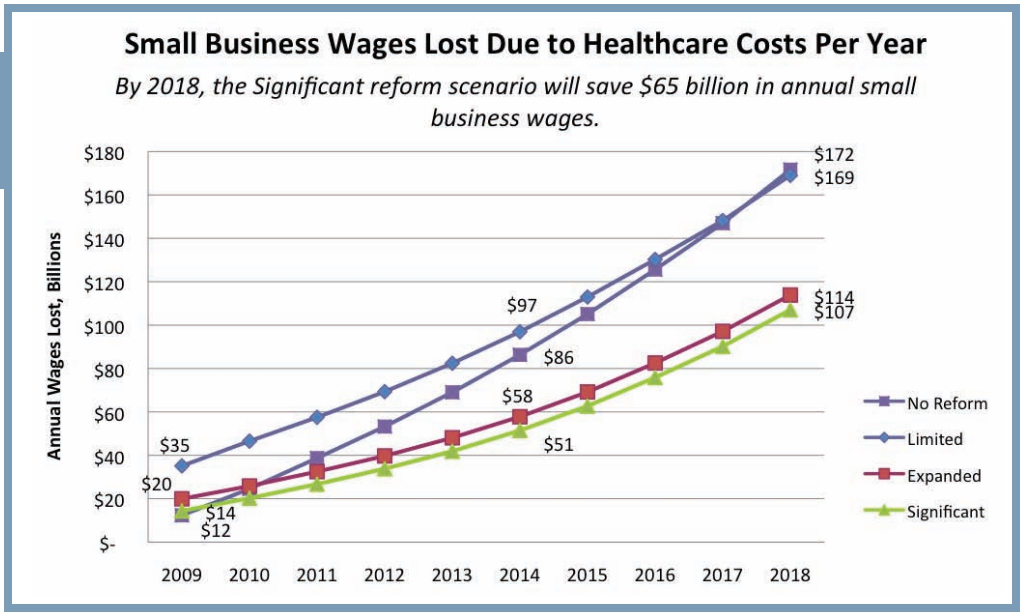


Annual impact of healthcare reform

Dr. Gruber's model shows that healthcare reform will save workers billions of dollars in wages relative to the wages lost due to health costs with no change to our health system (see Chart 10). The amount of wages reform will save, and when those per-year savings begin, varies widely and depends on the level of small business support in that reform. The Limited reform scenario provides a relatively low level of support for small businesses, and so does not offer relief for small business workers' wages. For most of the years analyzed, wage losses under the Limited reform scenario are higher than losses under the current system due to the new requirement that small businesses share the responsibility for providing health coverage for their employees. In 2018, total estimated wage losses under the Limited reform scenario are $169 billion, or a 2-percent wage savings compared to estimated wage losses under the current system.

The reform scenarios offering small businesses larger targeted tax credits and more support in sharing responsibility are projected to significantly protect wages from health costs relative to allowing the current system to continue. By 2013, the Expanded reform scenario begins saving small business employees wages on a per-year basis, and the savings come a year sooner under the Significant reform scenario. In 2018, the Expanded reform scenario would mean $114 billion in reduced wages due to health costs, but saves 34 percent of wages (or $58 billion in wages) otherwise lost under the current system. In 2018, the Significant reform scenario would mean $107 billion in reduced wages due to health costs, but saves 38 percent of wages (or $65 billion in wages) otherwise lost under the current system.

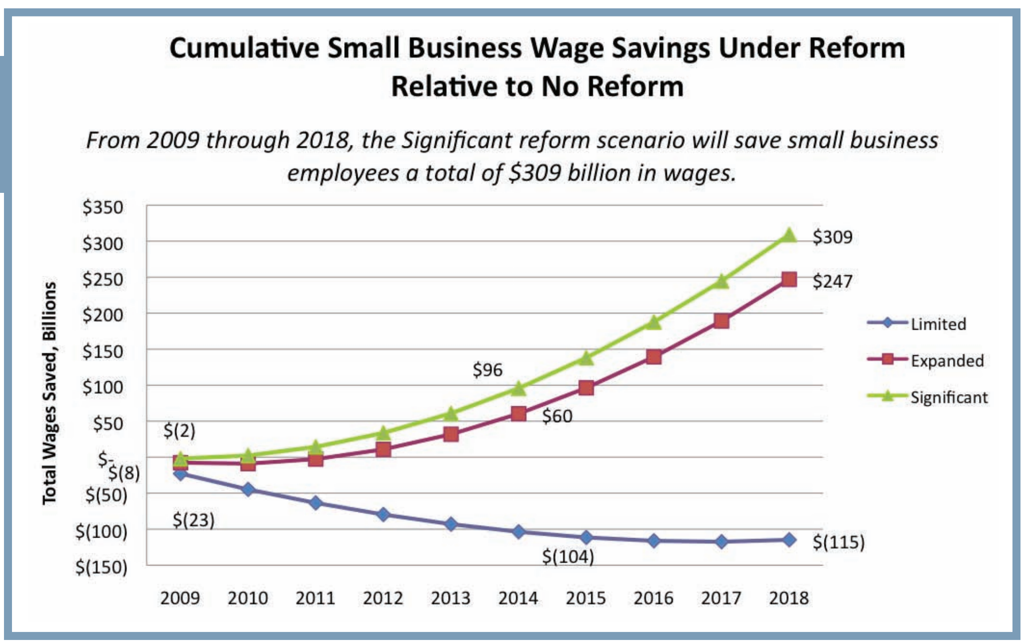
Chart 10



Cumulative impact of healthcare reform

The ten-year cumulative impact of healthcare reform shows how important healthcare reform design will be to protecting small business wages from high healthcare costs. Relative to the current system, the Limited reform scenario will reduce small business wages by an additional $115 billion between 2009 and 2018, as shown in Chart 11. In comparison, both the Expanded and Significant reform scenarios have the potential to save workers hundreds of billions of dollars in wages that would otherwise be lost due to high healthcare costs. Over the ten-year period, and despite a relatively low level of additional costs, the Expanded reform scenario would save $247 billion in wages lost under the current system. The Significant reform scenario would save $309 billion in wages lost under the current system.

Chart 11



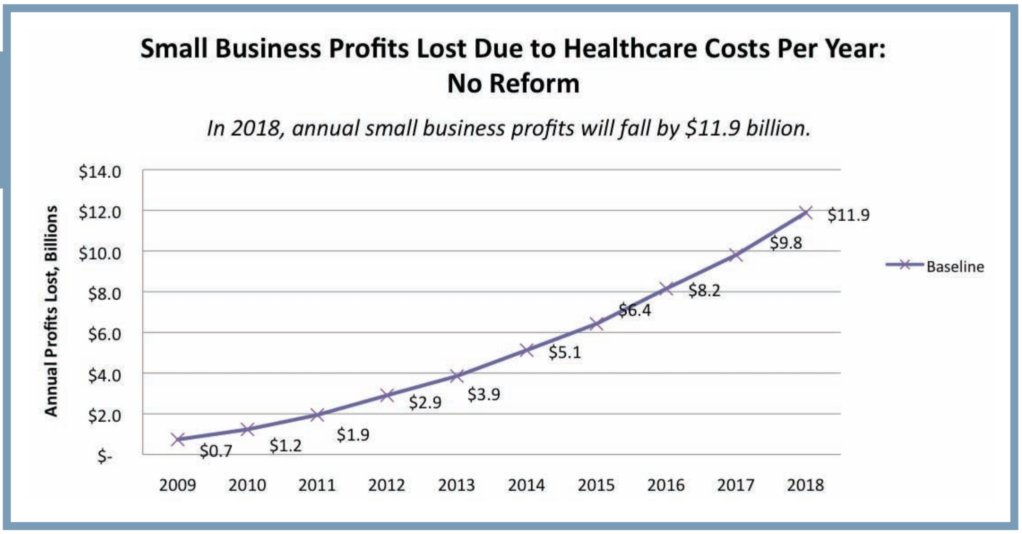
Healthcare reform will allow small businesses to reinvest profits to grow their businesses and the economy

Small businesses are the driver of economic productivity in the U.S. The Gruber model estimates that small business profits under the current system will total more than $626 billion in 2009, a significant portion of which is reinvested in our economy. Small businesses have faced increasing economic stress in recent years from both the current economic downturn and rising healthcare costs. Their productivity is slowed when health costs cannot be passed on to employees, and profits (and, in turn, small business owners' ability to grow their businesses through reinvestment) are reduced. This hurts not only existing businesses, but also business formation as the incentive to operate a business is reduced.

Impact of continuing the current system

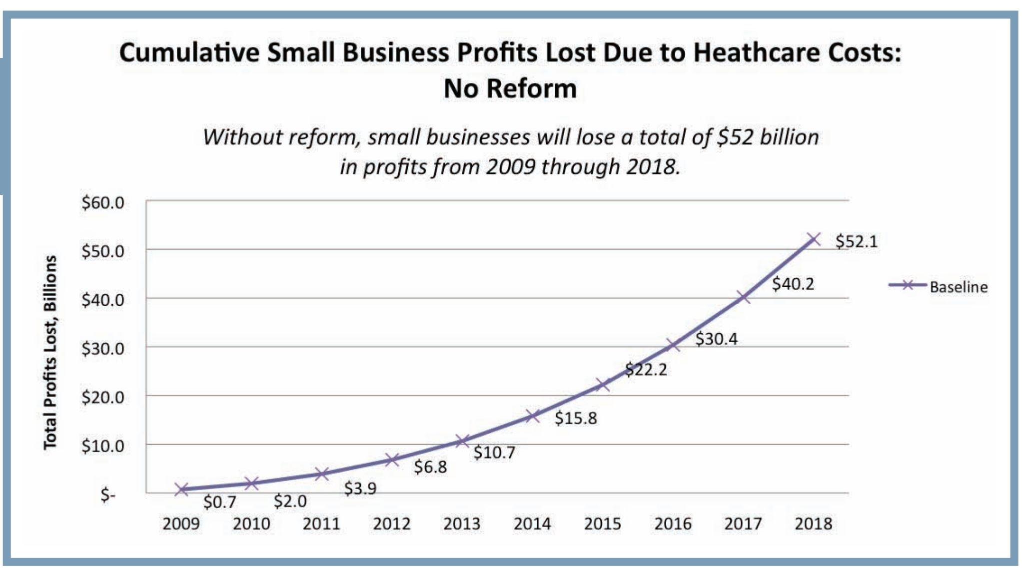
Without healthcare reform, healthcare costs will continue to be too large for small businesses simply to pass on to workers, meaning that small business owners must absorb those costs in their bottom line. In 2009, small businesses will lose an estimated $700 million in profits due to rising healthcare costs, and those annual lost profits will grow to reach $11.9 billion in annual lost profits by 2018, as shown in Chart 12.

Chart 12



The cumulative impact of the current system on small business profits is even greater. If the current system is allowed to continue, small business profits will be reduced by $52.1 billion between 2009 and 2018 due to high healthcare costs, as shown in Chart 13.

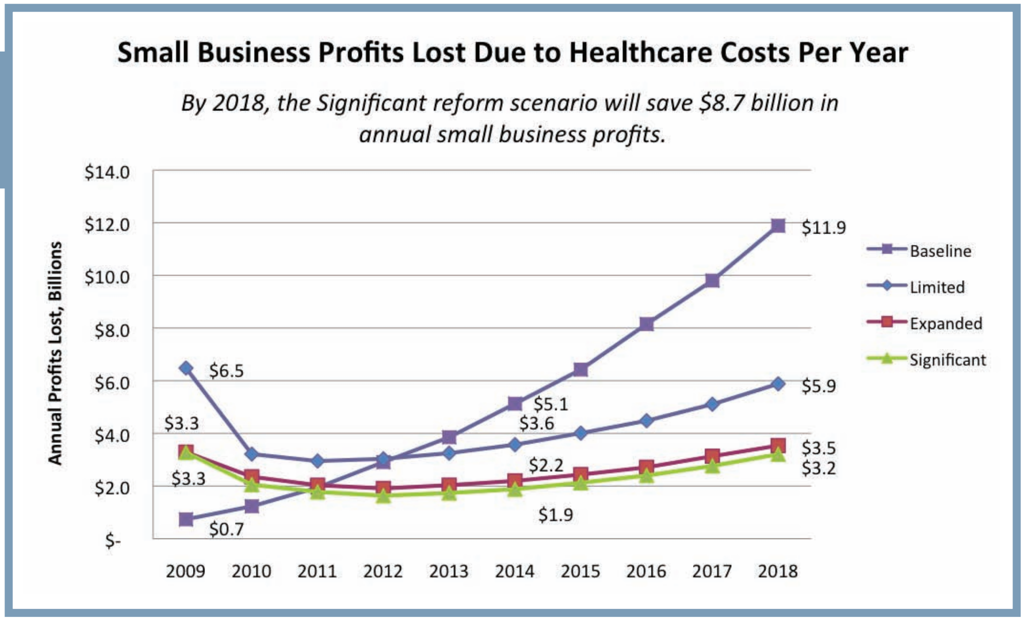
Chart 13



Annual impact of healthcare reform

Without healthcare reform, the profits small business owners must spend on high healthcare costs and cannot reinvest in their businesses will grow steadily over the next ten years. In comparison, small business owners will see increased profits within several years under all three reform scenarios. How much profit savings small business owners will see from healthcare reform, and when those savings begin, depends on how reform is structured to support small businesses. Profits lost due to healthcare costs on a per-year basis are lower under the Limited reform scenario than the current system beginning in 2013. In 2018, annual profits lost due to healthcare costs will be cut by more than half relative to the current system, to just $5.9 billion. Under the Expanded reform scenario, small business owners will begin seeing higher annual profits in 2012 relative to what would have been lost due to healthcare costs in the current system. And in 2018, 70 percent of profits lost due to high health costs in the current system will be saved. Under the Significant reform scenario, small business owners will begin seeing higher annual profits in 2011 relative to what would have been lost under the current system. In 2018, 73 percent of profits lost due to high health costs in the current system will be saved under the Significant reform scenario.

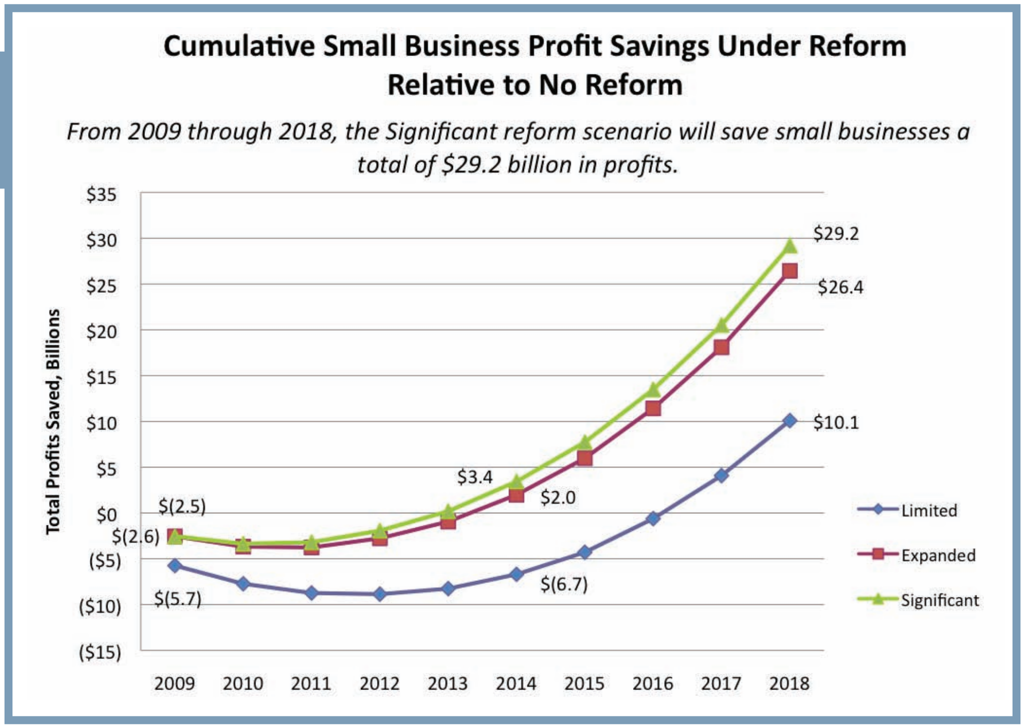
Chart 14



Cumulative impact of healthcare reform

The cumulative impact of healthcare reform on freeing small business profits for reinvestment in our economy depends on how well reform is structured to support small businesses. As shown in Chart 15, the first years of healthcare reform will require small businesses to invest profits in expanding health coverage for their employees. However, the return on this investment is significant profit savings over time. Under the Limited reform scenario, small business owners will not begin to see a net increase in profits, relative to allowing the current system to continue, until 2017. By the end of the period, small business owners will see $10.1 billion in additional profits relative to the current system. Under the Expanded and Significant reform scenarios, which provide more support to small businesses, small business owners will begin seeing a net increase in profits much sooner. For the Expanded reform scenario, net profit savings begin in 2014, and total $26.4 billion over the ten-year period. For the Significant reform scenario, net profit savings begin a year sooner in 2013, and total $29.2 billion over the ten-year period.

Chart 15



Healthcare reform will end job lock, and allow workers to change jobs—and start new businesses—without the fear of losing their health coverage

Today, it is difficult for families to find affordable health coverage outside of the employment-based system. This affects people's job choices, and creates the phenomenon of "job lock," where individuals stay in their jobs just to maintain their health insurance coverage.[22] The federal government and some states have taken steps to increase the portability of coverage, allowing workers who have left their jobs to pay to continue their group coverage through a program called COBRA. This coverage is expensive and time-limited, and the federal law does not apply to workers in firms with fewer than 20 employees.

Whether or not a firm offers coverage, and the specifics of that coverage, still affects the choices employees make.[23] Studies have shown that the fear of losing health insurance lowers mobility between jobs by between 25 and 50 percent.[24] The impact of the employment-based system of health insurance on how people make job choices can affect small businesses' ability to attract and retain employees. And it may prevent those small business employees who want to become entrepreneurs and start their own small businesses from doing so out of fear of losing their insurance.

Under the current system, Dr. Gruber's model shows that 1.6 million small business workers are job-locked; 6.3% of the small business workers who have insurance from their employer are ineligible for public insurance and do not have a spouse with employment-based coverage. Healthcare reform that provides workers with access to comprehensive health insurance no matter where they work, through the health exchange or a public plan as some proposals suggest, will reduce job lock to nearly zero. Small business employers will be able to find and keep the employees they need to be successful and economically competitive.

Conclusion

Small businesses in the United States are suffering great harm under our current healthcare system and will likely fare far better under a substantially reformed system along the lines of what is currently being debated in Washington. A system that substantially contains costs, guarantees access to coverage regardless of health status, and is based on shared responsibility among individuals, business, government and the healthcare industry—and also offers appropriate levels of assistance to small businesses in meeting their healthcare obligations. Such a system will save small businesses hundreds of billions of dollars in costs, protect small business wages and jobs—and allow small business owners to continue to reinvest in and grow our economy.

A system that is most likely to benefit small business will include employer contribution obligations that are phased in on a sliding scale for businesses under $1 million in annual payroll and/or fewer than 50 employees, along with tax credits for small businesses under similar payroll and/or employee thresholds.

Appendix: Methodology

The analysis in this paper is based on the Gruber Microsimulation Model (GMSIM) developed by Dr. Jonathan Gruber, professor of Economics at the Massachusetts Institute of Technology. This well-known model has been used to analyze the impact of numerous healthcare reform plans, and is similar to the models used by the Congressional Budget Office, the Joint Tax Committee and other government scoring organizations.

GMSIM takes into account how any change in the health insurance market impacts both individuals and firms in a two-step process. GMSIM considers first how insurance prices will change for individuals and firms, then how individuals and firms will change their behavior due to the price change. It is assumed that individuals make their choices based on both the types of insurance available (employer, individual or public) and the cost of available choices.

In modeling firm choices, GMSIM assumes firms make decisions based on how healthcare reforms affect their workers. For example, firms with low-wage workers are more likely to change their behavior following an expansion of public programs to cover those types of workers than firms with high wage workers who still would not qualify for public coverage. To determine this, Gruber used individual-level data to create "synthetic firms" of statistical coworkers matched to real workers in a unique database provided by the Bureau of Labor Statistics (BLS). After determining the impact of reforms on the workers in these synthetic firms, the model determines how the firm would react.

Most economic theory and evidence suggests that, in the long run, employers do not face the full costs of health coverage for employees, and the model takes this into account in determining the firm reaction. Employers will shift the costs of healthcare to workers by lowering wages or reducing worker hours. However, there are barriers in the short run that prevent employers from shifting the full cost.[25] Those barriers include minimum wage laws and other constraints employers face in directly lowering wages to compensate for higher employee healthcare costs. For example, it is easier not to increase wages to keep up with inflation over the long term than to impose an immediate cut in a worker's nominal wage. How much of immediate increases in healthcare costs can be passed on to workers depends on how much employees value health benefits relative to wages. For each reform scenario the model calculates the "non-shifted health insurance costs" businesses face that cannot be passed on to workers through lowering wages, laying off workers or reducing employee work hours.

In addition to the data from BLS, the main data source for the model is the Current Population Survey (CPS), which provides information on:

- Family demographics;
- Tax rates;
- Insurance coverage;
- Employer-based (or group) insurance costs;
- Distribution of premiums across employers and employees. Data from the Medical Expenditure Panel Survey is used to determine premiums by firm location and size; and
- Individual, non-group insurance costs, adjusted for location, age, sex and health status.

The Kaiser Family Foundation provided the data on the costs of public insurance, including data by states and groups of beneficiaries.

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Dr. Jonathan Gruber is a professor of economics at the Massachusetts Institute of Technology, where he has taught since 1992. He was elected to the Institute of Medicine in 2005, and in 2006 received the American Society of Health Economists Inaugural Medal for the best health economist in the nation aged 40 and under. In 2006 he was appointed to the board of the Massachusetts Insurance Connector, the main implementing body for the state's ambitious healthcare reform effort, and was named the 19th most powerful person in healthcare in the United States by Modern Healthcare Magazine. In 1997-1998 he served as deputy assistant secretary for economic policy at the Treasury Department.

Dr. Gruber's research focuses on public finance and health economics. He has published more than 100 research articles, edited four research volumes, and authored Public Finance and Public Policy, a leading undergraduate text. He is a co-editor of the Journal of Public Economics, and an associate editor of the Journal of Health Economics

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In planning and implementing this study, Small Business Majority convened a six-person economic advisory council to advise us on the proper scope of inquiry, recommend the best economist to do the work, and analyze the study's findings.

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