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INCREASING HEALTH INSURANCE COSTS FOR SMALL BUSINESSES
KANSAS' 3RD CONGRESSIONAL DISTRICT

PREPARED FOR REP. DENNIS MOORE

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EXECUTIVE SUMMARY

The cost of health insurance for small businesses is a critical issue in Kansas and across the country. In Kansas, small businesses employ over 400,000 people, half of the workforce in the state. Rising health insurance costs can force small businesses to reduce coverage, increase employee contributions, and even cease to provide health insurance.

Rep. Dennis Moore, who represents the 3rd Congressional District in Kansas, requested this report in order to assess the impact of rising health insurance costs on small businesses in his congressional district. The findings in the report are based on a survey of over 450 small businesses in Rep. Moore's district. The report is the first study of the effect of increasing health insurance costs on small businesses in the Kansas City area.

The report finds:

- **The cost of health insurance for small businesses in Rep. Moore's congressional district is increasing rapidly.** In the last year, average health insurance costs for small businesses in Rep. Moore's congressional district increased by 23%, over 14 times the rate of inflation. This represents an annual cost increase of over $900 per employee. Over the last five years, average health insurance costs for small businesses in Rep. Moore's congressional district have increased by 84%, seven times the rate of inflation. This represents a five-year annual cost increase of over $2,200 per employee.

- **Health insurance cost increases for small businesses in Rep. Moore's congressional district are accelerating**. Health insurance costs for small businesses in Rep. Moore's congressional district have increased at an average rate of 13% annually over the last five years. But in the last year, this rate of increase has almost doubled. And health insurance costs for small businesses in the district are expected to increase by almost 20% again in 2003.

- **Health insurance costs are rising the fastest for the smallest businesses.** Though these firms are less able to absorb rising costs, insurance rates for firms with fewer than 10 employees have increased by

27% in the last year. This is an average yearly increase in cost of more than $1,100 per employee.

- **The increases in health insurance costs are resulting in reduced coverage and may cause many small businesses to end coverage entirely.** Cost increases have forced three-quarters of small businesses surveyed in Rep. Moore's congressional district to reduce benefits. Nearly two-thirds of these small businesses have been forced to increase employee copayments for doctor visits and hospitalizations; almost three of every four have reduced prescription drug coverage; and almost half have been forced to pass increased insurance costs on to their workers. Over half of surveyed businesses in Rep. Moore's congressional district indicated that if health insurance costs continued to increase, they could be forced to eliminate health insurance coverage completely.

BACKGROUND

The cost of health insurance for small businesses is a growing concern in Kansas and across the country. In Kansas, small businesses employ over 420,000 people, half of the state's workforce.[1] Many of these employees and their dependants would lose their health insurance if their employers were no longer able to provide coverage.

Although all Kansas employers are faced with increasing health insurance costs, small businesses face greater difficulties providing insurance coverage for their workers than large employers. Small firms have less leverage to bargain for lower rates from insurance companies than do large corporations. As a result, both insurance deductibles and premiums are higher for small firms than for large firms, meaning small business owners and employees are forced to pay higher prices for less generous health insurance coverage.[2] Moreover, many small businesses cannot afford coverage at all. National surveys have indicated that although virtually all large employers offer health insurance coverage, only 61% of small businesses are able to offer coverage to their employees.[3] In Kansas small businesses are also less likely to provide coverage than their larger counterparts.[4]

The ability of small businesses to provide coverage is being strained by steadily increasing health insurance costs. National data indicate that the cost of health insurance for small businesses increased by 13.2% in 2002, over eight times the rate of inflation.[5] Moreover, 2002 marked the sixth consecutive year of rising health insurance costs for employers, with rates expected to continue increasing at

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1 U.S. Census Bureau, *Statistics of U.S. Businesses* (2002) (online at www.census.gov/epcd/susb/1999/ks/KS--.HTM).

2 Kaiser Family Foundation, *Employer Health Benefits: 2002 Annual Survey* (2002).

3 *Id.*

4 Health Affairs, *Private Employer-Sponsored Health Insurance: New Estimates by State* (January/February 2000).

5 Kaiser Family Foundation, *supra* note 2, at 12.

a rapid pace.[6] A recent survey indicated that health insurers demanded premium increases exceeding 20% for 2003.[7]

Several factors account for the rapidly increasing costs. The single most important factor appears to be rapidly increasing prescription drug costs, which were named by almost two-thirds of businesses nationwide as a factor that contributes "a lot" to increasing health insurance costs.[8] In addition, over half of employers reported higher spending for hospital care as a cause of increasing costs, and almost half reported higher spending for physicians as a cause. [9]

These rising costs place an increasingly large burden on small business owners and employees, threatening health insurance coverage and availability. Small businesses faced with rising health insurance costs are increasingly using drastic measures to cut costs. These strategies include decreasing employer contributions to insurance premiums, increasing employee cost sharing, reducing employee eligibility, and reducing the scope of the coverage.[10]

In some cases, small businesses are dropping coverage altogether.[11] In 2002, almost 40% of small businesses did not offer employee health coverage, an increase of almost one-fifth compared to the number of businesses that did not offer coverage in 2000.[12] The high cost of coverage was the most frequently cited reason why these small businesses did not offer coverage.[13]

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6 *Id.*

7 *Health Insurers Are Seeking 20% Rate Rise,* New York Times (June 5, 2002).

8 Kaiser Family Foundation, *supra* note 2.

9 *Id.*

10 Center of Studying Health System Change, *Cutting Back Not Cutting Out*, Issue Brief 56 (October 2002).

11 *Id.*

12 *Id.*

13 *Id.*

OBJECTIVE AND METHODOLOGY

Because of concerns over rapidly increasing health insurance costs for small businesses, Rep. Dennis Moore requested that the Special Investigations Division of the minority staff of the Committee on Government Reform conduct an investigation into health insurance costs in his congressional district. Rep. Moore represents the 3rd Congressional District in Kansas, which includes Kansas City, Lawrence and the surrounding counties. Rep. Moore requested that the investigation examine both the extent to which health insurance costs are increasing for small businesses in his congressional district and the impact of these increases on employers and employees.

The report is based on responses by small businesses to a survey conducted in Rep. Moore's congressional district. Rep. Moore's staff distributed the survey to businesses on the registries of local Chambers of Commerce throughout the 3rd Congressional District. Four hundred and sixty-two small business operators responded to the survey, answering questions about the cost of insuring their employees and the effects of rising costs on their firm.

This report summarizes the results of the survey. It is the first report on the effect of increasing health insurance costs on small businesses in the Kansas City area.

FINDINGS

The survey of Rep. Moore's congressional district revealed that 85% of firms responding to the survey offered health insurance to their employees. Among these firms, the average employer contributed 83% of the cost of health insurance premiums, with employees responsible for the remainder. The average small business health insurance policy in Rep. Moore's congressional district costs $4,860 per employee per year.

The survey data also show that health insurance costs are increasing rapidly, causing severe problems for small businesses in the district. These cost increases are leading to reductions in coverage and higher costs for employees, and they

may cause many employers to stop offering coverage entirely. The data also reveal that the smallest firms — those with fewer than ten employees — have faced the largest cost increases.

Health Insurance Costs for Small Businesses Have Increased by 23% in the Last Year

The cost of health insurance is rising rapidly. The survey data indicate that between 2001 and 2002, average health insurance costs for small businesses in Rep. Moore's congressional district increased by 23%, over 14 times the inflation rate during the same time period.[14] This represents an annual cost increase of over $900 per employee.

Health insurance costs are increasing even faster for businesses in the 3rd Congressional District with fewer than 10 employees. These businesses, comprising 47% of survey respondents, had an average single-year increase of 27%, or 17 times the rate of inflation.

For many small businesses, health insurance increased faster than these averages indicate. One in eight small businesses reported that their health insurance costs had increased by over 33% in the last year alone, and 6% of small businesses reported that their health insurance costs increased by over 50%.

Survey data also indicate that costs are expected to continue increasing rapidly. The businesses surveyed in Rep. Moore's congressional district are predicting that insurance costs will increase by 19% in 2003.

Health Insurance Costs for Small Businesses Have Increased by 84% in the Last Five Years

Health insurance costs for small businesses in Rep. Moore's district have been

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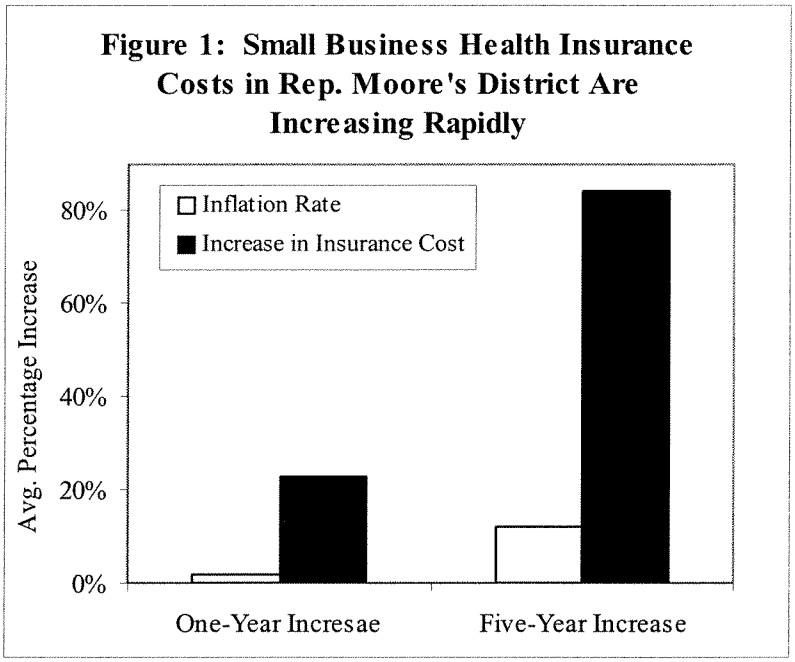
[14] The Consumer Price Index increased by 1.6% in 2002. Bureau of Labor Statistics, *Consumer Price Index* (2003) (online at www.bls.gov/cpi/).

increasing for several years. The survey data indicate that over the last five years, average health insurance costs for small businesses in the district increased by 84%, almost seven times the inflation rate over that same time period.[15] *See* Figure 1. This represents a five-year annual cost increase of over $2,200 per employee.



As with last year's increase, the five-year rise in insurance costs has been greater for businesses insuring fewer than 10 employees. For these businesses, premiums have increased nearly 89% on average since 1998.

In many cases, individual businesses faced even larger increases. More than one-third of small businesses reported that their insurance costs increased by over 100% over this five-year period, and over 5% reported that their insurance costs more than tripled.

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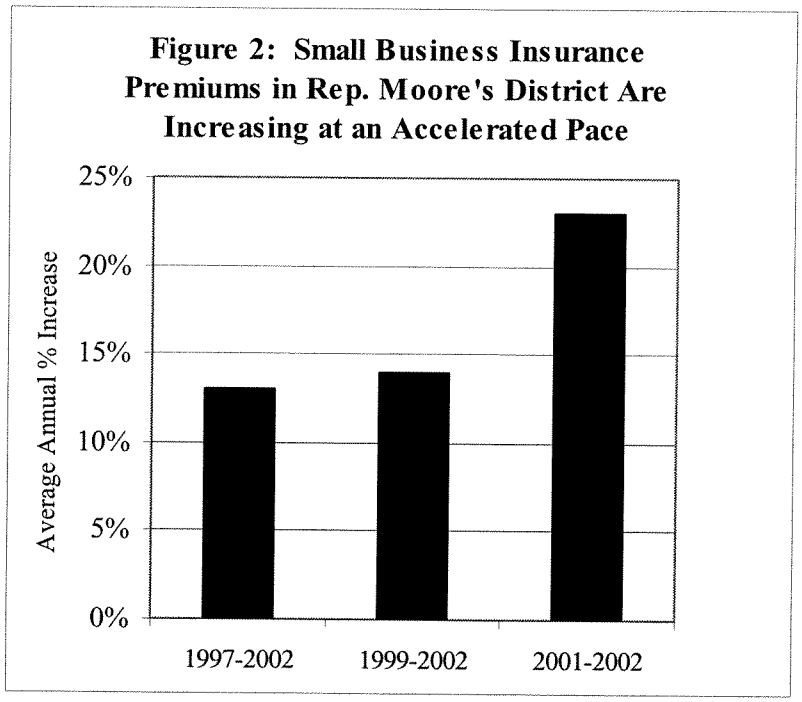
[15] The Consumer Price Index increased by 12.1% from 1998-2002. *Id.*

Health Insurance Cost Increases for Small Businesses Are Accelerating

The survey data indicate that the increase in health insurance costs for small businesses is accelerating. Health insurance costs for the small businesses surveyed in Rep. Moore's congressional district increased by 84% over the last five years. This is an average annual increase of 13%. In the past year alone, costs have increased by 23%. *See* Figure 2.

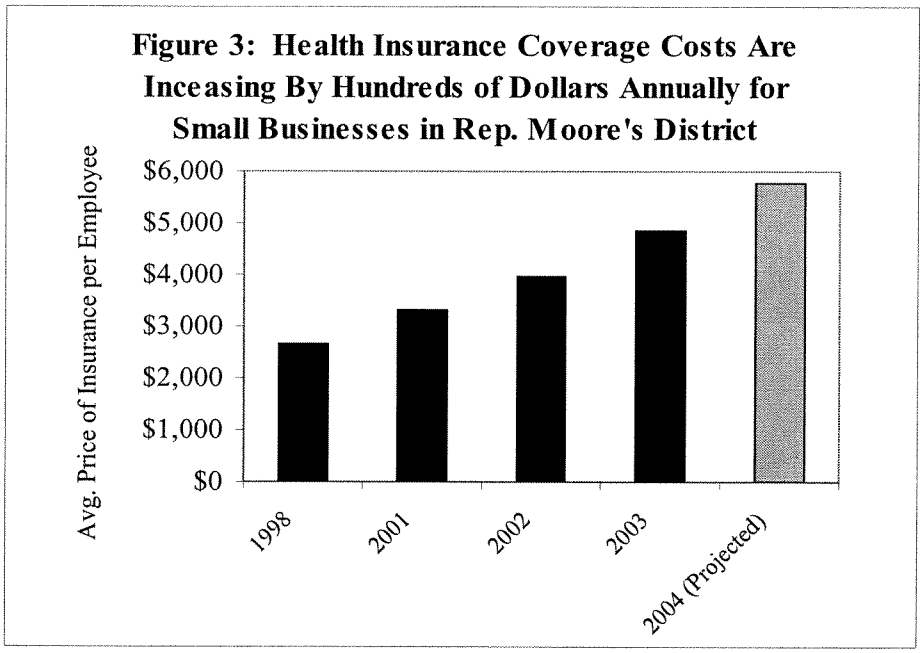


Compared to the rate of inflation, health insurance costs for small businesses in the district have increased seven times faster than the inflation rate in the last five years, but 14 times faster than the inflation rate last year.

Survey data also indicate that costs are expected to continue increasing rapidly. The businesses surveyed in Rep. Moore's congressional district are predicting that insurance costs will increase by 19% in 2003.

In dollar terms, the increases have been dramatic. The average policy for a small

business employee in the 3rd Congressional District costs $4,860 per year for each employee covered in 2003. This is an increase of over $2,200 compared to the $2,640 annual insurance cost in 1998, and an increase of $1,550 from the $3,310 annual insurance cost in 2000. If costs increase by the anticipated 19% in 2003, small business owners will pay $5,780 per employee next year, an additional increase of over $900 per year. *See* Figure 3.



The Increase in Health Insurance Costs for Small Businesses Is Affecting Coverage

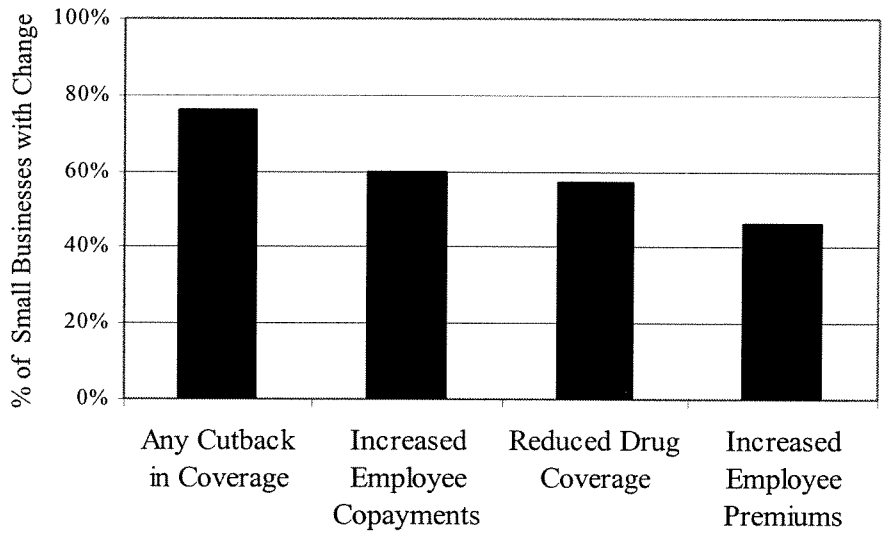
Survey data from the small businesses in Rep. Moore's congressional district indicate that increasing health insurance costs are having a significant impact on coverage, causing many employers to reduce coverage or even stop offering health insurance entirely as a benefit. One employer summarized the problem: "We have raised the deductible to $2,500, cut [the] covered percentage [of costs paid by the employer] to 60%, and raised the co-pays. It's almost like not having coverage at all anymore - but we have to choose these cuts to be able to afford the premiums."

Overall, 75% of the surveyed small businesses — three out of every four — have had to cancel or reduce benefits in recent years. Survey data indicate that:

- 60% of small businesses have been forced to increase their employees' copayments for doctor visits and hospitalization;
- 57% of small businesses have had to reduce prescription drug coverage; and
- 46% of small businesses have passed increased insurance costs on to their employees.

See Figure 4.

Figure 4: Increasing Insurance Costs Are Forcing Small Businesses in Rep. Moores's District to Reduce Coverage or Increase Employee Costs



Many small businesses have been forced to switch health care plans in search of lower costs. Overall, 58% of the small businesses surveyed have either recently switched plans to reduce costs or are planning to switch this year. For many small

businesses, switching insurance companies is the only available cost-cutting strategy, although it often involves reducing some benefits. One respondent described the difficulty of obtaining low rates: "This is a serious problem for us as a small business. We get no benefit on rates due to our small size, and pay essentially individual rates."

Survey data also indicate that the recent reductions in coverage will continue if insurance costs keep rising as they have. Eighty-six percent of the small businesses surveyed in Rep. Moore's district indicated that rising health insurance costs represented a significant problem. Moreover:

- 57% of small businesses are considering increasing their employees' copayments for doctor visits and hospitalization if costs continue to increase;
- 51% of small businesses are considering reducing prescription drug coverage if costs continue to increase; and
- 62% of small businesses are considering passing increased insurance costs on to the employees if costs continue to rise.

Almost half of the small businesses surveyed in Rep. Moore's congressional district (47%) indicated that if health insurance costs continued to increase, they would be forced to eliminate health insurance coverage completely. Some small businesses indicated that they have already taken this step. Several indicated that because they were unable to afford health coverage for their employees, they have been forced to hire employees with less skill to fill part-time positions without health benefits.

COMMENTS OF SMALL BUSINESS OWNERS

Comments from small businesses that responded to the survey underscore the problems of rising insurance costs and indicated the extent to which these costs pose long-term problems for small businesses.

Several small businesses expressed concerns about the extent to which rising costs were harming employees, forcing reduced salaries and other benefits. One business owner said, "In these years when we have such large increased

premiums, there simply are no increases in . . . pay for the fiscal year. Rather than increase employee [insurance costs], we elect to make no raises for said fiscal year." Another noted that "it has very much become a major factor for us. With the current economy, and business so competitive, we cannot increase our prices to clients, so we have to absorb all overhead operating increases. Each . . . increase [in health insurance costs] is like a salary cut to employees." Another business owner summarized the difficulty for his employees by observing: "Increased costs may require some families to make a decision . . . food or medical insurance."

Other small businesses indicated that rising health insurance costs and the difficulty of providing adequate benefits for employees placed them at a competitive disadvantage. One small business owner noted, "this is a major issue all small businesses are facing. We are losing good employees to larger companies that can offer better benefits. It also eats away at the ability to turn a profit."

One survey respondent summarized the concern and the risks to all small businesses: "We have been in business 33 years and never did we dream that the cost of insurance . . . would threaten our business the way it has in the last 5 years. There has to be an end or businesses such as ours will be a thing of the past."

CONCLUSION

Small businesses in Rep. Moore's congressional district face numerous problems providing health insurance for their employees, and these problems are exacerbated by rapidly increasing health insurance costs. Results from a survey of small businesses conducted in Rep. Moore's district indicate that health insurance costs have risen by 84% in the last five years, and by 23% in the last year alone, with similar increases expected in 2003. Firms with fewer than 10 employees suffered even greater increases: 89% over five years and 27% in the last year alone.

These cost increases have caused over 75% of the small businesses surveyed in the district either to reduce coverage or to pass additional costs on to employees or both. Three quarters of respondents also indicated that they are considering additional cuts to benefits this year. Almost half of the small businesses surveyed may be forced to drop health insurance coverage entirely if costs continue to increase.