20. State-Based Health Care Solutions

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Health insurance purchased by individuals and small businesses is principally regulated by states, but the employer-group insurance model does not function well for the self-employed and those who work for small businesses. These individuals and their dependents account for a disproportionate share of the uninsured. Efforts by states to improve coverage in those market segments by standardizing benefits and imposing rating restrictions on health insurance have largely failed to achieve measurable improvements and, in some cases, have actually resulted in fewer insured individuals. State policymakers should try a different approach.

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Recommendation

Replace states' small-group and non-group health insurance markets with single, statewide health insurance exchanges through which the self-employed and those who work for small businesses can buy personal, portable, tax-advantaged coverage. During the past two decades, state insurance reform efforts have focused mainly on trying to make health insurance in the small-group market more affordable on the theory that the cost of coverage is the principal obstacle to small businesses offering their workers health insurance. However, the real problems are the difficulties faced by small businesses in designing and managing employer-sponsored plans for a few workers in businesses with high employee turnover, coupled with the fact that employment-based coverage is not portable. The fact is that employment-based health insurance works well only for long-term employees of large firms, and Medicaid coverage is reliable only for the very poor. Neither system, alone or in combination, is doing an acceptable job of ensuring health care coverage for the people who fit neither of these categories.

Health Insurance Exchange. States should replace the present system with a new, more flexible one designed to ensure greater continuity of health insurance coverage. Specifically, they should restructure their health insurance markets by creating new, statewide "health insurance exchanges" through which insurers would offer policies that combine the best features of the current group and non-group insurance markets. As in the current group market, an exchange would offer an annual open season during which participants could select or switch coverage and

health status would not be a rating factor. However, as in the current non-group market, coverage would be fully portable, with participants able to keep their chosen coverage when changing jobs or employers.

A state health insurance exchange would serve as a market organizer, providing a single, centralized system that facilitated the buying and selling of heath insurance. It would essentially perform the same function for health insurance that stock exchanges do in facilitating the buying and selling of securities. State reforms would also be crafted in a way that enabled employers of any size to designate the exchange as their group health insurance plan for purposes of federal regulation and tax law, allowing their workers to buy their preferred coverage through the exchange using any combination of tax-free employer contributions and pre-tax payroll deductions.

Benefits to Workers, Small Businesses. In addition, a state health insurance exchange would administer premium-aggregating mechanisms, including a uniform payroll withholding system, to facilitate the collection of premium payments and combine contributions from multiple sources. For example, a two-earner couple would no longer have to choose coverage from one spouse's employer and forgo the coverage contribution offered by the other spouse's employer. Instead, they could combine the contributions from the two employers and use the total amount to buy the coverage they really want for their family through the exchange. Similarly, an individual with two part-time jobs could ask for prorated contributions from both employers and then combine them to buy coverage through the exchange. This system would also make it administratively much simpler for states to provide targeted premium-assistance subsidies to low-income workers and families.

With these features in place, small employers would no longer face the risks and administrative burdens associated with trying to obtain group coverage for a handful of employees. Rather, a business could designate the exchange as its group health insurance plan and give its employees whatever tax-free contribution it could afford to help them buy coverage. Insurance brokers would continue to receive commissions for bringing employer groups and individuals to the exchange. They would earn these commissions by providing workers with benefits counseling to help them pick the best plan for their personal situations and by assisting employers in setting up arrangements, currently permitted under federal tax law, that make the share of the premium paid by their workers also tax-free to the workers. While such arrangements are common among large firms, small firms rarely offer them.

State governments should also take the lead by providing health insurance to their own employees through the exchange. This would have several positive effects. *First,* state government workers would gain a wider choice of coverage options. *Second,* it would facilitate getting coverage to employees, particularly contractual and contingent workers, who are currently uninsured. *Third,* the presence of such a

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large number of workers and their dependents would be a catalyst for ensuring the exchange's success. Insurers would have a huge market incentive to offer attractive benefit packages at attractive premiums through the exchange, while small businesses and their employees would be eager to join. Finally, the cost of coverage for state workers might decline somewhat because the average age of employees in large businesses and governments tends to be significantly higher that the average age of small-business workers and the uninsured.

Notes

Facts and Figures

- Almost half (47.2 percent) of the uninsured have family incomes of $30,000 or more, and one-quarter (26 percent) have family incomes of $50,000 or more, according to an Employee Benefit Research Institute study based on Current Population Survey data.

- The same study reports that over four-fifths (83.4 percent) of the uninsured live in families with at least one worker; that almost two-thirds (62.1 percent) live in families with at least one full-time, full-year worker; and that almost half (49.7 percent) of all uninsured workers are either employed by businesses with fewer than 25 employees or self-employed.

- Studies published by *Health Affairs* and the Commonwealth Fund reflect that the long-term uninsured comprise only a small portion of the total uninsured population. Millions of people cycle in and out of health insurance coverage, largely as a result of employment changes.

- A recent Commonwealth Fund study that looked at the total population experiencing one or more spells of uninsurance over a four-year period found that only 12 percent were consistently uninsured. In contrast, one-third (33 percent) cycled repeatedly in and out of insurance coverage, and a further 29 percent had experienced coverage gaps during the four-year period.

This chapter can be read online at issues2006.org/stateinitiatives.

Additional Reading

Edmund F. Haislmaier, "Covering the Uninsured in Maryland: Futile Gestures or Real Reforms?" Maryland Public Policy Institute, *Maryland Policy Report* No. 2006-2, January 17, 2006, at *www.mdpolicy.org/research/pubID.86/pub_detail.asp*.

Robert E. Moffit, Ph.D., and Nina Owcharenko, "Covering the Uninsured: How States Can Expand and Improve Health Coverage," Heritage Foundation *Backgrounder* No 1637, March 14, 2003, at *www.heritage.org/research/healthcare/bg1637.cfm*.