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Small Business And The National Health Care Reform Debate

by Jennifer N. Edwards, Robert J. Blendon, Robert Leitman, Ellen Morrison, Ian Morrison, and Humphrey Taylor

Many of the legislative proposals to address the growing problem of uninsured Americans to date have focused on improving access to health insurance for small businesses. This focus is sound for three reasons. First, the impact could be quite large—over 53 percent of the uninsured work for small businesses, and many more are dependents of someone who works for a small firm.\(^1\) Second, these reforms retain our current employment-based system of providing health insurance—a system that is favored by a large number of employers and employees. Third, the reforms expand access to health insurance without requiring that the federal government raise taxes.

Proposals targeted at covering employees of small businesses have taken two forms. The first, reforms of the small-group insurance market, attempt to address many of the problems small businesses face in offering health insurance to employees: high costs, rising rates, policy cancellations, lack of access to a policy due to insurance policies such as “redlining” (that is, excluding) specific industries, exclusions of certain individuals or illnesses, and lack of information about rates.\(^2\) Such proposals retain the voluntary nature of health benefits and only attempt to regulate the sale of policies by insurance companies. The second group of proposals focuses on providing access to insurance for small businesses as part of a comprehensive program to cover all of the uninsured. Universal access proposals fall into three categories—employer mandates, “play-or-pay” proposals, and single-payer programs—and the effect of any policy on small businesses will depend on the financing levels set in the legislation.\(^3\) A variety of tax rates and subsidy levels are being considered.

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Here we explore the likelihood of each proposal’s success in covering the employees of small businesses. To do so, we report the results of our national survey of small businesses, which asked about the decision to purchase health insurance and attitudes toward health care reform. We then discuss the implications of current health care reform proposals for small businesses and their employees, drawing on this survey and others.

**Methods.** In January and February 1991, Louis Harris and Associates, in conjunction with the Institute for the Future and the Harvard School of Public Health, conducted a national telephone survey of 501 small businesses about their purchase of health insurance and attitudes toward health care reform. The respondent at each firm was the chief executive officer or the senior executive most knowledgeable about the company’s policy on health benefits. The sample was drawn randomly from the Dunn and Bradstreet U.S. Enterprise and Establishment Microdata File. The sample was stratified by three sizes of firms: one to five employees, six to twenty-five employees, and twenty-six to one hundred employees. Forty-nine percent of small businesses who were contacted completed the survey. While response rates of 49 percent are generally subject to significant nonresponse bias, the survey does represent a relatively high response rate for this population.

**Health Benefits In Small Firms**

Six findings from our survey and other studies enhance our understanding of the likelihood that small businesses will provide health insurance in the future.

**Wage and benefit policies of small firms.** Small businesses are less likely than large businesses to provide health insurance and all types of fringe benefits to their employees, and they pay lower wages than large firms. We found that half of firms with one to five employees offer health insurance to all or some employees; three-fourths of firms with six to twenty-five employees do so; and nine out of ten firms with twenty-six to one hundred employees offer benefits. Most small firms pay at least half the cost of the policy for the employee.

Through the 1980s, the share of jobs in small businesses increased slightly. In 1980, 48 percent of all jobs were in firms with fewer than 100 employees; by 1990, the proportion had increased to 51 percent. Small firms as a percentage of all businesses held steady at 98 percent throughout the decade. Large firms pay, on average, 35 percent more in wages and provide a more comprehensive range of fringe benefits (Exhibit 1).

Health insurance is the most widely offered fringe benefit in small firms, and yet one-third of all small businesses do not provide health insurance coverage for employees. Our study found that the primary
reason was pragmatic: 54 percent of respondents believe that the cost is too high. A survey conducted by the National Federation of Independent Business (NFIB) found additional, more philosophic reasons. Not only are small firms concerned about costs, but a majority (64 percent) also reported that they do not believe that employers have a responsibility to provide health insurance for their employees.\(^7\)

The other reasons given by small employers in our survey for not providing insurance are less significant when compared with cost. These include: (1) employees are generally covered under a spouse’s or parent’s policy (23 percent); (2) the business cannot qualify for a policy (3 percent); (3) employee turnover is too high (3 percent); or (4) the business has no trouble hiring without offering benefits (2 percent). Another factor that may affect their decision is that small employers are able to get insurance for themselves and their families without covering their employees. Two-thirds of respondents who do not provide insurance for their employees reported having coverage for themselves.

There is considerable evidence that size alone is not a good explanation of why small firms do not provide insurance. The Health Insurance Association of America (HIAA) has found that wages are a good predictor of a small firm’s decision to provide insurance benefits. Firms in which a majority of workers earn more than $10,000 a year are three times more likely to provide health benefits than are firms with workers earning less than $10,000 a year.\(^8\) There are also differences in the demographics of small firms that provide insurance and those that do not. Firms not offering insurance are more likely to have higher proportions of part-time, female, and low-wage workers.\(^9\)

Small business trade associations have reported that their members are not profitable enough to provide health insurance.\(^10\) However, our review of the literature did not turn up any data that support this claim.
The difficulty in assessing this claim is that a good measure of a firm’s ability to provide insurance has not been developed. Accounting principles blur the distinction between a firm’s profitability and the earnings of the owner. Charles Brown and colleagues point to data that cast doubt on the belief that many small employers cannot afford to provide health insurance. The incomes of owners of small firms compare favorably with those of large-firm owners; and families who own small businesses have incomes almost twice as high as the income of the average U.S. family and own assets more than five times as large.

Reduction of future benefits. As a result of rising premium rates, small businesses are considering reducing their health insurance coverage in the future. The cost of benefits is a major concern for small firms now providing insurance benefits. Nearly two-thirds (62 percent) of small business respondents reported that they perceive their health care costs to be out of control. If insurance costs continue to rise 20 percent or more a year (a reasonable forecast for this segment of the market), more small-business respondents anticipate more cost shifts and cutbacks in benefits for their work force. Small businesses often do not have the option to shift more costs to their employees because some insurance companies require the employer to pay for the bulk of coverage to obtain a small-group policy. Because of the high cost of insurance, 30 percent of small firms reported that they are likely to eliminate company-paid health benefits in the future. This is consistent with recent behavior of small businesses; 13 percent of firms in our survey reported having dropped their health insurance benefits in the past three years.

Incentives to cover workers. For small employers not now covering their employees, it would take a very large reduction in the current cost of health insurance to induce them to offer coverage. To understand what public policy changes might improve coverage for the uninsured, we queried small businesses that do not provide benefits about what incentives would lead them to offer benefits to their employees. They were given four choices of health plans: a stripped-down insurance policy (one devoid of state-mandated benefits), a health maintenance organization (HMO), a plan with limited choice of providers, or a public plan such as Medicaid. Each option was offered at three price discounts. Respondents were more willing to purchase the plan that was offered at the lowest price, regardless of the type of plan (Exhibit 2).

The Robert Wood Johnson Foundation’s Health Care for the Uninsured program reported similar findings. In nine demonstration sites, new insurance products or subsidized existing products were made available to uninsured small businesses at premiums ranging from 9 to 60 percent below those of other health insurance products in their respective local markets. According to estimates made by the independent
project directors, fewer than 25 percent of the eligible businesses have chosen to buy the policies.\textsuperscript{12}

**Dissatisfaction with the health care system.** Perhaps because of the serious cost problems they face, small businesses reported being highly dissatisfied with the U.S. health care system—much more dissatisfied than are large employers (Exhibit 3). On average, three out of ten small-business respondents believe the health care system has so much wrong with it that it needs to be completely rebuilt. About half of small businesses want to see fundamental changes, and 16 percent think only minor changes are needed. Small-business owners are less supportive of fundamental change than nonowners are. About a third (32 percent) of owners believe the system needs to be completely rebuilt. Compared with senior executives of large companies, as reported in a nationally representative survey of large businesses (over 100 employees) conducted in 1990 by Louis Harris and Associates, small-business owners are much more likely to favor completely rebuilding the system.\textsuperscript{13}

**Support for universal access.** Two-thirds of small businesses would support changing from the current health system to one providing universal access. Unlike larger businesses, almost half of small businesses prefer an all-governmental system. When given a choice of a single-payer all-governmental system, mandated employer coverage with an
Exhibit 3
Attitudes Of Business Toward The U.S. Health Care System, 1991

<table>
<thead>
<tr>
<th></th>
<th>Large business</th>
<th>Small business Owners</th>
<th>Small business Nonowners</th>
</tr>
</thead>
<tbody>
<tr>
<td>On the whole, the health care system works pretty well, and only minor changes are necessary to make it work better</td>
<td>21%</td>
<td>17%</td>
<td>15%</td>
</tr>
<tr>
<td>There are some good things in our health care system, but fundamental changes are needed to make it work better</td>
<td>69</td>
<td>47</td>
<td>57</td>
</tr>
<tr>
<td>The health care system has so much wrong with it that we need to completely rebuild it</td>
<td>10</td>
<td>32</td>
<td>26</td>
</tr>
<tr>
<td>Not sure</td>
<td>0</td>
<td>4</td>
<td>2</td>
</tr>
</tbody>
</table>


a n=239.
b n=246.

expanded public program, or the present system, about half of small businesses support a single-payer system, one in six prefer an employer mandate, and three of ten prefer the present system (Exhibit 4). Companies not offering insurance are more likely to prefer an all-governmental system (56 percent) than are those who offer insurance (45 percent).

We find two reasons why small businesses are more likely than large businesses to favor a governmental solution. First, small businesses lack

Exhibit 4
Small And Large Business Preferences For U.S. Health Care System

<table>
<thead>
<tr>
<th></th>
<th>Percent responding</th>
</tr>
</thead>
<tbody>
<tr>
<td>Present system</td>
<td>31 35 49</td>
</tr>
<tr>
<td>Employer mandate</td>
<td>15</td>
</tr>
<tr>
<td>Single-payer national health insurance</td>
<td>27</td>
</tr>
</tbody>
</table>

the capacity for exploring the health insurance choices that large businesses enjoy. Possessing smaller staffs and less-specialized roles within the firm, small businesses do not spend much time investigating their insurance options (most small businesses spend fewer than ten hours a year investigating health insurance). Most small firms that offer insurance rely on insurance agents when they contract for insurance and use the agent as the primary source of information about their options. The second reason may be a limitation of our question: We did not state the size of the tax burden on small businesses of an all-governmental health plan. Our results suggest that small businesses will choose the lowest-cost insurance option, even if it is an all-governmental plan. The NFIB reached a similar conclusion in a recent analysis of Health America, the proposal of the Senate Democratic leadership. The federation reported that under this particular plan, firms that pay employees less than $12.50 per hour would find it cheaper to pay the tax than to provide insurance.\textsuperscript{14}

If there is to be a national health plan, small employers have a preference for how it is to be financed (Exhibit 5). Our survey shows that small businesses prefer to finance expansions in coverage through hidden taxes such as alcohol and tobacco taxes (70 percent) or a premium paid by the people covered (64 percent). Only 31 percent favor an employer payroll tax, and 24 percent would choose an income tax. Small-business owners are more likely to oppose an employer payroll tax

---

**Exhibit 5**

**Small Business Support For Different Ways Of Financing Expanded Coverage And Controlling Costs, 1991**

<table>
<thead>
<tr>
<th>Financing options</th>
<th>Favor strongly</th>
<th>Favor somewhat</th>
<th>Oppose somewhat</th>
<th>Oppose strongly</th>
<th>Not sure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Higher taxes on alcohol and tobacco</td>
<td>44%</td>
<td>26%</td>
<td>11%</td>
<td>17%</td>
<td>2%</td>
</tr>
<tr>
<td>Premiums paid by people covered</td>
<td>24</td>
<td>40</td>
<td>19</td>
<td>14</td>
<td>2</td>
</tr>
<tr>
<td>Employer payroll tax</td>
<td>5</td>
<td>26</td>
<td>30</td>
<td>38</td>
<td>1</td>
</tr>
<tr>
<td>Income tax</td>
<td>3</td>
<td>21</td>
<td>26</td>
<td>49</td>
<td>1</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Cost-Control options</th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Controls on prescription drug prices</td>
<td>50%</td>
<td>31%</td>
<td>9%</td>
<td>8%</td>
<td>2%</td>
</tr>
<tr>
<td>Hospital price controls</td>
<td>50</td>
<td>25</td>
<td>12</td>
<td>12</td>
<td>1</td>
</tr>
<tr>
<td>Physician price controls</td>
<td>43</td>
<td>27</td>
<td>12</td>
<td>16</td>
<td>2</td>
</tr>
<tr>
<td>Limits on high-technology services</td>
<td>13</td>
<td>24</td>
<td>34</td>
<td>27</td>
<td>2</td>
</tr>
<tr>
<td>Longer waits for non-urgent care</td>
<td>7</td>
<td>29</td>
<td>33</td>
<td>27</td>
<td>4</td>
</tr>
</tbody>
</table>

than respondents who are not owners (49 percent versus 26 percent). Owners also oppose income taxes more strongly than nonowners. Most national proposals now acknowledge a need to control health care costs while expanding access. Small businesses prefer governmental cost controls on hospitals, doctors, and prescription drugs over limiting access to major medical technology or increased waiting times for nonurgent care.

**Political concerns.** Although most small businesses are concerned about high health care costs, health care reform is not a salient political issue for most of them. Our survey shows that most respondents’ votes in state and national elections would not be strongly influenced one way or the other by a candidate’s position on health system reform (Exhibit 6). However, it appears that politicians who support employer mandates or who advocate no change at all face the most political risk, especially in the eyes of those voters whose vote would be influenced one way or the other by health system reform issues. These negative attitudes could carry over into the agendas of the small-business trade associations and their campaign contributions. Seven political action committees explicitly represent small business, and dozens more trade and industry groups speak for concerns of small business. The committees’ total contributions are about 60 percent of the size of large businesses’ contributions and thus have significant potential to influence political outcomes.  

**Policy Implications**

Our primary finding is that it will be difficult to get small employers to buy health insurance for their employees unless a very large subsidy is offered. Even with a reduction as large as 50 percent, only half of small businesses would consider buying health insurance for their employees. 

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**Exhibit 6**

Small Business Support For Political Candidates Favoring Various Health Care Policies

<table>
<thead>
<tr>
<th>Health care policy</th>
<th>Much more likely</th>
<th>Somewhat more likely</th>
<th>Somewhat less likely</th>
<th>Much less likely</th>
</tr>
</thead>
<tbody>
<tr>
<td>All-governmental health insurance</td>
<td>13%</td>
<td>36%</td>
<td>26%</td>
<td>21%</td>
</tr>
<tr>
<td>Expand Medicaid to cover all of the poor</td>
<td>8</td>
<td>39</td>
<td>31</td>
<td>16</td>
</tr>
<tr>
<td>No change in the current system</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Employer mandate</td>
<td>6</td>
<td>22</td>
<td>3</td>
<td>38</td>
</tr>
</tbody>
</table>

firms that do not now insure their workers are likely to elect to buy insurance. The results of our study suggest that the government will have to mandate coverage or subsidize the cost of a policy to induce small businesses to offer insurance. We found that offering a 30 percent government subsidy (and likewise a 30 percent reduction in price) is not enough to persuade most firms to buy insurance. If policymakers choose instead to provide a tax credit or subsidy to small firms to help defray the cost of providing insurance, it will be important to take into account the findings of Brown and colleagues, which suggest that some small businesses are able to afford to pay for coverage. We recommend developing an indicator of a business’s financial ability to provide benefits and using it as a means test to determine the size of the subsidy given to each small business to apply toward its health insurance purchase. The measure should take into account the profitability of the firm and the wages of employees. A means-tested subsidy of this nature could significantly reduce the cost of a subsidy to the government.

Given the resistance to purchasing a policy and the size of the subsidy that would be needed, a mandate (or play-or-pay option) may be the only route to achieving broad insurance coverage of small business workers and their families. However, this will not be achieved without some cost to politicians in political support (in the form of votes and contributions from the national organizations that represent small business).

Finally, for those who have suggested that the best policy may be to muddle through with only small, incremental changes, our analysis suggests that the number of uninsured workers in small businesses will continue to grow. If our survey proves true, in the years ahead, 30 percent of small businesses currently providing insurance will drop their insurance coverage because of the high cost. This will leave our system with more uninsured people who lack a regular source of care, greater uncompensated care burdens on hospitals, and more pressure on large firms to pay for the care of the uninsured in their communities.

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NOTES


2. Proposals to reform the small-group market by the Health Insurance Association of America; Blue Cross and Blue Shield Association; National Association of Insurance Commissioners; Reps. Dan Rostenkowski, John J. Rhodes and Tim Johnson, Fortney (Pete) Stark, and Henry A. Waxman; Sens. Lloyd Bentsen, Dave Durenberger, Jay Rockefeller, and George J. Mitchell; and over fifteen states are summarized in “Regulating Health Insurance in the Small-Group Market” and in State Health Notes (7 October 1991), published by the Intergovernmental Health Policy Project at The George Washington University.

3. Employer mandates require that all employers offer insurance to their employees. Play-or-pay proposals give employers the choice of providing health insurance or paying a tax so that their employees can get coverage through a public plan. Single-payer systems centralize the purchase of health insurance in a single national insurance system.

4. The Dunn and Bradstreet database is the most complete publicly available source of data on small business and has been used by the U.S. Department of Commerce.

5. The margin of error on responses ranges from ±4 percent when the total sample is used (n=501) to ±9 percent when just the uninsured businesses’ responses are reported (n=151). The response rates vary by firm size: 44 percent for the smallest firms (one to five employees), 47 percent for medium firms (six to twenty-five employees), and 57 percent for the larger firms (twenty-six to one hundred employees). We expect that firms that do not provide benefits are likely to be underrepresented.


9. Data from Alpha Center, in “Regulating Health Insurance in the Small-Group Market.”


12. Alpha Center, personal communication, February 1992. It should be noted that the insurance products offered to small businesses through these demonstration projects varied considerably in price, benefits, and plan design, and price may not have been the only factor in employers’ purchasing decisions.


15. Brown et al., Employers Large and Small.

16. Ibid.