

Final Results: Impact of Small Group Reform in Wisconsin

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In this memo I briefly lay out the results of modeling a subset of small group reforms in Wisconsin designed to remove health as a rating factor for small businesses. I consider a reform that restricts rating as follows:

- No health rating
- A 4:1 band on age rating
- A 1.2:1 band on case size rating

This modeling proceeded in several steps

- 1) The initial step was for Gorman Actuarial to model the effect of the various proposed reforms on the premiums facing each firm in the small group market.
- 2) Gorman Actuarial then provided a data file with information for each small firm in the state, with information on: premiums before reform, percentage change in premium due to each reform, and various rating factors
- 3) I then used their data to model for each firm in my data a base premium, and the change in premium due to each reform.
- 4) I then modeled the effect of the change in price from reform for each firm on firm behavior and individual behavior. I also included a reduction in overall premiums in the small group market of 7%, reflecting the gains from managed competition, and reducing broker fees.
- 5) Based on the change in composition of workers in the small group market, I recomputed the average premium in the market, and then additionally modeled the change in behavior due to average premium change. The end result is a dynamic model of the impacts on the insurance market that reflect both the distributional impacts of reform and the overall effects on market pricing.

Results of Reforms

The results of this exercise are presented in Table 1. In this table, the first column shows baseline values for the state of Wisconsin. The next column show the changes from that baseline due to each of the two reforms noted above. The top panel shows population movements across employer-sponsored insurance, non-group insurance, and the uninsured (the movements in and out of public insurance are negligible and not presented here). The bottom panel shows the impact on premium rates, total employer and employee spending on insurance, state fiscal impacts, and the share of firms and workers who are “winners” from reform.

It is important to begin with a caveat. All of the results presented here are from a modeling exercise that inherently involves substantial uncertainty. There is a natural tendency when reading results such as these to draw strong inferences from relatively small differences in results. But such inferences would not be warranted. These results are best read as providing relative guideposts to reform impacts, not precise estimates of exact effects.

This reform causes some displacement from employer-sponsored insurance and some increase in the uninsured, although the effects are relatively modest. The reason for this finding is that the firms that “lose” from this reform (firms with relatively healthy and/or young workforces) are dropping insurance coverage at much higher rate than firms that “win” from this reform (firms with relatively sick and/or older workforces) are adding insurance coverage. This is partly inevitable in a market where insurance coverage is relatively high (for example, if insurance coverage before the reform were 100%, coverage could only fall!). But it is also because the sicker/older firms are more likely to already offer insurance before the reform, so there is even less room for them to increase coverage.

The second panel of the table shows financial impacts of reform. The first row shows the impact of the reform on premiums, accounting for (a) the assumed 7% savings from reduced broker fees and managed competition, (b) the impact on average prices of the reform itself and (c) any impact of prices through the changing composition of the employer-insured. I find that the reform leads to a roughly 4.9% decline in average premiums, as the 7% assumed savings is offset by rising prices through the reform and a shift towards somewhat less healthy firms buying insurance.

Spending by both employers and individuals fall, as shown in the next two rows, due both to (a) declining prices and (b) a declining base of employer-provided insurance. There is no effect on state Medicaid costs, but a modest rise in state tax revenues as lower employer insurance spending is translated to higher worker wages and therefore higher state tax revenues. Therefore, this policy on net saves the state \$5 million/year.

The final two rows show the share of firms, and the share of workers, who are “winners” from the reform. This winners/losers analysis is shown from two perspectives. The first is the firm perspective: what share of firms are winners or losers? The second is the worker perspective: what share of workers are winners or losers? These differ because premium changes may differ by firm size: if, for example, the largest among these small firms tend to be most likely to be winners, then there will be a higher percentage of winners from the worker perspective than from the firm perspective.

Roughly half of firms are “winners”, as the assumed reduction in premiums offsets the losses to healthy firms from higher insurance costs. But the majority of workers are losers, reflecting the fact that it is larger firms that see the highest premium increases through reform.

Offsetting Reforms with Targeted Tax Credits

The goal of market reform is to reduce the excessive and variable premiums faced by firms with sick workers, but one unfortunate by-product, as documented above, is a rise in premiums for those firms with healthier workers. This leads to an erosion in group insurance and increase in the number of uninsured. The state of Wisconsin can potentially offset these negative effects, however, by injecting resources into the small group market. In this section, I consider the impacts of a targeted credit of different sizes.

The ideal tax credit to offset the negative impacts of reform would be one that is tied precisely to the characteristics of firms that are associated with the size of the premium “shock” due to reform. That is, in theory, one could create a credit which is literally tied to the change in costs that each firm faces from reform. In practice, that is impossible to do because that change in costs depends on factors unobserved by state regulators, such as the health of the workforce.

I therefore consider the closest possible approximation to this idealized credit, which is a credit which is targeted to firms based on the age and gender of their workers and the size of the firm. These are two of the major factors that determine the impact of the reforms under consideration, so by targeting to them we can both reduce the premium increases experienced by firms that “lose”, and reduce the rise in uninsured from this policy.

The results of introducing this credit are presented in the remaining set of columns in Table 1. Since the size of the credit is uncertain at this point, I show results for a variety of credit sizes: \$50 million per year, \$100 million per year, \$150 million per year, and \$200 million per year.

A credit of \$50 million per year offsets much of the negative insurance impacts of reform, with the number of employer insured falling by only 5,000 persons and the number of uninsured going up by only 5,000 persons. There is some movement from public insurance coverage through Medicaid and SCHIP to employer-sponsored coverage, which is more attractive (as witnessed by the fact that most individuals who are offered ESI but are eligible for public insurance still take up ESI). Essentially, the credit neutralizes the impacts of this reform on the insurance market.

The credit also has important impacts on employer spending. Premiums fall by more than in the no credit case, as the credit serves to offset the adverse selection impacts of the reform; premiums now decline by 6% that is assumed to be saved through managed competition and reduced broker costs. In addition, firms save through the credit amount they receive from the state, so that on average the per member per month cost of insurance falls by 8.8%, accounting for both the premium savings and the credit transfer from the government to firms. There is a larger reduction now in employer spending on insurance, due to the credits flowing to employers that offset increased employer coverage relative to the no credit case. There is a small savings in state Medicaid costs,

and a larger rise in state tax revenues, so that the net cost of the credit is the targeted \$50 million/year. As expected, this credit produces more winners as well, so that the majority of both firms and workers are winners. The credit rises with firm size, since larger firms lose the most from reform, which accounts for the fact that there is a larger rise in winners from the worker perspective than from the firm perspective.

The remaining columns show progressively larger credit amounts. As the credit amount rises, the negative impacts on group coverage turn positive, and the positive impacts on uninsurance become. With a \$200 million credit, for example, group insurance rises by over 30,000, and the number of uninsured falls by 15,000.

There are also larger savings to firms from larger credits. Some of these savings come from a fall in premiums as healthier and healthier firms take up small group insurance. And some comes from the rising size of the credit itself. As a result, for the largest credit, the cost of health insurance to small firms falls by almost 20%. Over two-thirds of firms, and four-fifths of workers, are winners under this reform.

Policy Issues

In conclusion, it is important to raise two policy issues related to these reforms. First, one factor that is not captured in these analyses is the ability of insurers to offset restrictions on health rating by strengthening the role of age rating. This is unlikely to be a major focus of insurers given the relatively low correlation between age & health factors.

Second, it is important to consider this policy in the context of a larger state effort to both reform insurance markets and cover the uninsured. Even the largest credit considered here, at a state cost of \$200 million/year, causes little increase in insurance coverage in the state, with the number of uninsured falling by only 3%. Other policies could provide a large increase in insurance coverage for that level of funds. For example, the state could likely cover a large number of uninsured by further expansions in public insurance to the poorest citizens. Alternatively, this is a non-trivial share of the total cost of reform in the state of Massachusetts, which started with a similar number of uninsured to the figure in Wisconsin. For roughly \$1 billion in public sector costs, the state of Massachusetts has newly insured about 450,000 individuals.

Table 1: Effect of Market Reforms						
	Baseline Values	No Credit	\$50 Mn. Credit	\$100 Mn. Credit	\$150 Mn. Credit	\$200 Mn. Credit
Population Effects (thousands)						
Total Pop	4620					
Employer-Sponsored	3330	-21	-5	8	20	32
Non-Group	210	6	2	0	-1	-3
Medicaid/SCHIP	625	0	-2	-6	-10	-14
Uninsured	460	15	5	-2	-9	-15
Financial Effects (millions)						
Net Chg. Premium		-4.9%	-5.7%	-6.2%	-7.3%	-8.1%
Net Chg. Employer Spend		-4.9%	-8.8%	-12.4%	-15.6%	-18.9%
Employer Spending	10650	-65	-80	-100	-115	-130
Employee Spending	2260	-25	-30	-30	-35	-40
State Medicaid	1440	0	0	-5	-10	-15
State Tax Revenues	5475	5	5	10	10	10
Net State Cost		-5	-50	-100	-150	-200
% Winners: Firms		50%	55%	60%	64%	68%
% Winners: Employees		46%	54%	65%	74%	80%