

The Exchange: Exchanging Solutions for Leaky Band-Aids

By Dave Racer and Greg Dattiloⁱ

Governor Tim Pawlenty means well. He wants to make health insurance more accessible and affordable for Minnesotans. During October 2007, he said the way to do this is to create a Health Insurance Exchange, “To improve access and affordability of health insurance coverage in the private market. . .”¹

The Exchange is a state agency, available via a website and in other ways, established to sell individual health insurance plans to all Minnesotans.

- It requires that all individual health insurance must be purchased only through the Exchange.
- It will enroll people into both private and government-subsidized health plans.

The governor believes that the Exchange will reduce the rate of uninsurance and help to reduce the cost of health care.

The Exchange will not solve Minnesota’s current health care “crisis,” but it will make it worse because it fails to address the root problems that drive uninsurance and health care cost.

The Uninsured Crisis

State government officials are worried about the growing number of uninsured in Minnesota, and the ever-rising cost of health care and health insurance. At the same time, government budget managers are astonished by the rapid increase in state government spending required to provide health care services to low-income residents. As a result, leaders are studying plans to drive the uninsured rate down, to zero if possible, and to reduce the cost of health care.

It is essential to look at Minnesota’s uninsured rate in perspective. It has traditionally been between five and seven percent of the population. Minnesota continues to have the lowest uninsurance rate among all states, despite the fact that purchasing health insurance is voluntary; it is not mandated by law. From 2001 to 2004, however, the uninsured rate grew by 34 percent, from 5.6 to 7.4 percent. Certainly, it was prudent to examine the reasons and try to find a workable solution; perhaps even rewrite laws.

Unfortunately, some of our political leaders have been misdirected as it concerns the root cause of the increase in uninsured, and therefore, the methods by which they plan to reduce the uninsured are also misdirected. As a result, they have shown no inclination to address the root causes of uninsurance or health care inflation; they offer no workable solutions. They do, however, offer the Exchange.

¹ Pawlenty, T., “*Modernize MinnesotaCare; Establish the Minnesota Health Insurance Exchange; Extend Tax Benefits,*” News Release, Office of the Governor, October 23, 2007.

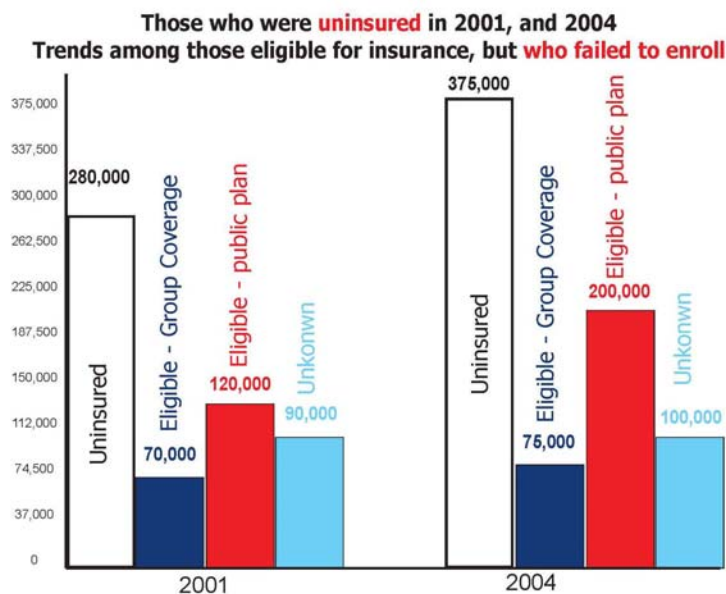
In a 2006 report issued by the Minnesota Department of Health,² the state reported on what had caused the surge in the uninsurance rate. The report states that the overall number of uninsured people rose by 34 percent, from 280,000 in 2001, to 375,000 in 2004. One of the report's key findings has been ignored. It deals with three distinct groups of individuals that are uninsured:

- Those who are eligible to enroll in their employer's plan, but choose to remain uninsured.
- Those who are eligible to enroll in government plans, but do not.
- Those who remain uninsured for which the pollsters had no explanation.

(It is instructive, as one reviews this survey's findings, that it polled employees and potential employees. It did not survey employers.)

Fact #1: The largest group of uninsured people are those who are eligible for government health plans, but fail to enroll. From 2001 to 2004, these increased at an astonishing rate of 67 percent, from 120,000 to 200,000 people. This is a clear indication that *the state is losing ground in its ability to enroll eligible people into its health plans.*

Fact #2: Employers and insurance agents continue to do a good job of enrolling eligible employees into company plans. Those who remained uninsured, even though they were eligible for an employer's plan, increased by 7 percent, from 70,000 to 75,000 people (less than 1.5% of the population).



² Health Insurance Coverage in Minnesota: Trends From 2001 to 2004, Minnesota Department of Health, and the University of Minnesota School of Public Health, St. Paul, MN, February 2006.

The state is failing to enroll eligible people into its health plans. Evidence from this report and from other surveys indicate that 65 percent of Minnesota employers continue to offer health plans, with a 97 percent take up rate. So how would a “Health Insurance Exchange” solve Minnesota’s uninsured problems? It could only do this if policymakers’ final intent is to create mandated universal health coverage and to use employers to insure the uninsured who current fall outside of their eligibility rules. The only way to enforce such a plan is by forcing employers to cooperate by tracking and reporting of the insurance status of their employees, and helping to fund the program.

Since this data comes from a state report, we presume that state leaders are aware of it. If this is so, then we should view the Exchange as the state’s strategy to solve its own problems on the backs of employers.

The Exchange is a problem, not a solution

The Exchange is established to make it easy for thousands of people to buy individual health plans. The Exchange attempts to incent employers and employees to sign up for health insurance by offering pre-tax dollars to help pay for individual health plans. There is a far simpler way of doing this without creating a new state bureaucracy: Licensed health insurance agents are already writing individual health plans. *The state would simply need to allow tax deductibility for those premiums, and ask federal lawmakers to do the same.*

The Exchange will actually encourage employers to drop coverage. Employers understand that many of their low-income employees already qualify for MinnesotaCare, but at this point in time, they have chosen instead to offer a paid benefit to them. Under the Exchange, employers are more likely to choose differently, and dump lower-income employees onto the state’s plan. This is already happening with the children of employees who qualify for SCHIP. (In these cases, often the parents move their children onto SCHIP-subsidized plans, and then drop their own coverage.)

Since the state already struggles with the spiraling cost of publicly-subsidized health insurance, the results of a wholesale dumping of employees onto MinnesotaCare could threaten the state budget.

The Exchange destroys an employer’s moral imperative : The Exchange separates employers from their sense of moral obligation to provide benefits to employees. In its place, it creates employer resentment toward government intrusion. Even if employers resent paying increasing health insurance premiums, most of them still prefer to take care of their employees, and see it as a rewarding fulfillment of their obligation to them.

The Exchange eliminates the employer’s competitive edge: Employers provide benefits in part because of competitive pressures. The health benefit often plays a pivotal role in hiring of new employees and retaining experienced employees. Under pressure to provide a defined contribution to fund Section 125 plans, employers lose this competitive edge.

Employers become relegated to serving as Minnesota’s Human Resource Department:

- Employers will track employees and report their health insurance status to the state.
- Employers will collect premium for covered employees that choose to purchase coverage through the Exchange and make payments to the state.
- Tracking employees and reporting data is an additional administrative burden for employers.
 - This will be a greater burden to employers who offer a choice between individual and group insurance plans.
- If coverage is made mandatory, and the employee refuses to allow the employer to withdraw premium from his or her paycheck, the employer will be forced to garnish wages to pay the premium.
- Employers may be held liable by employees if the Exchange's individual policy chosen by an employee does not cover mandated benefits covered under the employer's group plan.

Without this incentive, employers will be motivated to purchase bare bones coverage for employees that prefer group insurance. This will be truer if the state establishes a basic benefit package on plans offered through the Exchange.

So can the Exchange help to reduce Minnesota's uninsured rate or provide Minnesotans with affordable health plans? The answers to both questions are *no*. The Exchange will, instead, serve to increase the uninsured rate, and result in more expensive health care and health insurance.

Individual versus group health plans

The idea of unfettered free choice for employees in purchasing their own health insurance free from the bonds of employment seems attractive as a liberty issue. There are serious practical implications, however, that we explore in great length in another article.

It is instructive to consider auto insurance. Minnesota mandates that everyone who owns a vehicle must also own auto insurance.

- Minnesota's *health* uninsurance rate³ has recently toyed with eight percent. Health insurance is a voluntary purchase.
- The state's auto uninsurance rate floats as high as 17 percent, though it is mandated coverage. Why?
- Could it be that the crucial difference between who purchases and who does not purchase auto insurance versus health insurance is as simple as the fact that employers do not provide an auto insurance benefit to their employees? (We do not encourage employer-sponsored auto insurance plans as the solution for auto uninsurance.)

³ This measurement is based on dubious distinctions of limited use for policymakers. Among its many flaws is the simple fact that 75 percent of the uninsured remain so for less than a year. While that may constitute a crisis for those caught between coverage and no coverage, it does not portend a crisis in the larger population, and most certainly should not form the basis for a grand scale overhaul of health insurance public policy.

Moving toward the concept of individuals choosing or not choosing to purchase individual health plans appeals to those who believe in unfettered free choice. It is not without serious consequences, not the least of which will be driving up the uninsurance rate so that it more reflects that of auto insurance.

When uninsured motorists have accidents, their cars go without repair. When their bodies are damaged or become ill, they *will get treatment*, somewhere, somehow, *and someone will pay*. The answer to this dilemma is to encourage low uninsurance rates through affordable health plans, not separating health insurance as a benefit of employment to provide greater individual choice. Moving toward the separation of employer-provided group insurance may serve to increase the pressure for the state to enforce a mandated health insurance program, and even at that, it will never achieve what our current voluntary, employer-based system has achieved in terms of lowering uninsurance rates.

It is easy to imagine health uninsurance rates moving into the double-digits if health insurance is separated from employment: The next round of reforms will be focused on stopping runaway uninsurance rates. The “Star-Tribune” lead editorial will read, “Uninsurance has soared from 7.4% in 2007 to more than XX%. Clearly, the state must step in. The time for single payer health care has arrived.”

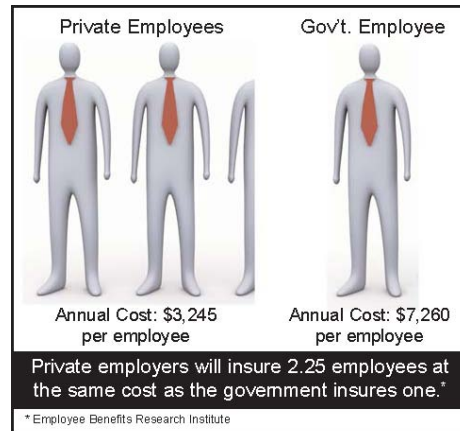
Why not move to a defined contribution plan?

The Exchange depends a great deal on the idea of employers paying a set amount each month to employees that chose to buy insurance through the Exchange: Paying a set amount is called a defined contribution plan.

The idea of a defined contribution plan is modeled after the Federal Employees Health Benefit Plan (FEHBP). The FEHBP works well for government employees, but for reasons that would devastate private employers.

- The FEHBP offers many plan design options from which employees may choose.
- The government pays a flat amount, the same to all employees.
- All employees single or with dependents, get the same benefit.
- Government employers give a great deal of money to their employees with which to purchase a health plan, more than what is affordable by most private employers.
- The government’s defined contribution is great enough that the employee can afford to enroll their dependents, even though if he or she might have to choose a stripped down health plan.
- Under the FEHBP, single people buy the richest plans, but those with dependents must purchase plans with fewer benefits.
- The single employee is over insured, while the employee with family coverage could be underinsured.

A defined contribution plan similar to the FEHBP is far more expensive than those purchased by most private employers. The Employee Benefit Research Institute found that government employers spend 225 percent more per employee on a health benefit than do private employers. Private employers can insure 2.25 employees for the same amount of money spent by government employers for one (1) employee.



In other words, to make the FEHBP work, the government provides an enormous insurance subsidy far in excess of what most private business could afford.

If Minnesota's political leaders choose a defined contribution concept based on the idea of the FEHBP, employers will adjust, but the state will not like the results. Without the competitive incentive to offer attractive health benefits, employers will shift as many employees as possible to subsidized plans. This will increase state spending on health care, and drive higher taxes for everyone, resulting in an imposition of a payroll tax on employers.

A payroll tax means that those who earn more will pay more for their insurance than those who earn less, but will receive the same coverage. They will receive less value for their earnings and have less incentive to work hard to earn more.

As it is today, employers pay the insurance cost of about 70-90 percent of its employees. The remaining employees choose not to enroll, or are covered under their spouse's employer plan. The employer budgets an amount of money necessary to pay the insurance premium for those who enroll, and is relieved from paying anything for those who do not.

Under the Exchange, the employer will either see premium costs go up, or will reduce the dollar amount of premium per individual and, therefore, offer a reduced benefit.

- If ABC Company currently employs 100 people, about 80 will sign up for health insurance. Assume that ABC budgets \$1,000 a month per employee and dependents, or \$80,000 a month for all covered employees.
 - Under the Exchange, ABC now sets up a defined contribution program, trying to be fair to all of its employees.

- All employees learn that they are entitled to a defined contribution. Everyone enrolls.
- ABC cannot simply add \$20,000 a month to its budget to cover the additional 20 people. Instead, ABC adjusts the per employee contribution downward to \$800, being careful to treat all employees the same.
- Each employee has less money to purchase health insurance, because everyone will choose to participate in a defined contribution plan.

The Exchange will require “fair” treatment of all employees. Those without dependents will not long tolerate the fact that someone with dependents receives more of a health insurance benefit than they do. This will drive employers to try to be “fair” with their revenue, by reducing or eliminating dependent coverage. This will result in an increase in the uninsured rate.

- If ABC Company currently pays the health benefits of single employees, it probably also offers dependent coverage to employees with a spouse and/or dependent children.
- If ABC pays \$300 a month to subsidize insurance premiums for employees, it will pay as much as an additional \$750 a month to pay for dependent health insurance.
- Under a defined contribution plan, the employer will no longer be able to afford nor feel obligated to subsidize insurance for dependents.
- The employer may raise the monthly benefit for all employees to \$450, but will eliminate payment for dependent coverage altogether. This will leave many spouses and children uninsured, increasing the call of political leaders for more money to enroll those who are now on the uninsured rolls.

Defined contribution plans on a wide scale have failed in the past. As private employers begin to analyze them, they recognize that families will suffer and they lose a competitive edge.

The root problems go unanswered

The Exchange fails to address the three most critical aspects our current dilemma, and as a result, threatens to make each worse:

1. It does nothing to reduce the overutilization of health care that wastes hundreds of millions of dollars. *Since it does not address consumerism, it does nothing to reduce the pressure for more unnecessary health care consumption.*
2. It offers no solution to address the largest cohort of uninsured: Hispanic/Latinos born in a foreign country, working part time and seasonal jobs.

- a. The 2004 Minnesota Department of Health study of changes in the uninsured⁴ identified the chief cause as an increase in temporary and seasonal employees, primarily of Hispanic/Latino origin born in a foreign country.⁵
3. It offers no plan to reduce the largest cohort of uninsured.
- a. The 2004 uninsured study shows that more than 59 percent of Minnesota’s uninsured were eligible for government programs – but they had not enrolled.
 - b. This identifies the most serious impediment to reducing the uninsured, while at the same time, revealing the greatest risk to Minnesota’s state budget.
 - c. Even with a mandate to purchase, the Exchange will not reduce the rate of uninsurance because a large number of this cohort refuses to sign up for an insurance plan, even if it is free. This is especially true of illegal immigrants, and they constitute 23 percent of the uninsured.
 - d. Furthermore, it is unlikely that those who are culturally opposed to health insurance and the methods by which U.S. providers deliver health care will suddenly choose to participate.

The Exchange means higher taxes:

The governor’s plan includes using the Exchange to enroll more people in MinnesotaCare and a new form of subsidized health insurance, MinnesotaCare II.

There really might be ways to encourage more low-income residents to sign up for these subsidized health plans, if reducing the uninsured rate is a serious goal. This would be especially true of the “working poor.” To do so, however, means driving up the level of spending of government health plans.

Minnesota’s budget shows no toleration for a radical increase in health care spending for more people. The only relief it can seek is higher taxes, and that is counter-productive.

Higher taxes attack wealth producers, especially employers and entrepreneurs who will be called upon to fund most of this increased cost, and will negatively affect job creation.

⁴ See note 2.

⁵ See note 2, page 12.

The Exchange does nothing to incent people to live healthier lifestyles. It offers no incentives for individuals to improve their health. On the contrary, it leaves in place the perverse incentives of mandated benefits, and the idea that the health care system is responsible to solve all health problems, including those based on lifestyle, and that someone else should pay the bill.

More importantly, there are other options available that are simpler and more effective.

A simpler tax solution:

A major purpose of the Exchange is so “*Employees* will be able to pay for coverage with pre-tax dollars, the same advantage enjoyed by people with coverage through their employers.”⁶ There is a far simpler way to do this that does require the creation of a new state agency: Make all health insurance premiums fully tax deductible for everyone, or, remove the deductibility status of health insurance premiums for everyone.

A single line in the state and federal tax code would solve this problem: “For the purposes of calculating adjusted gross income, each tax filer, no matter their status, may deduct 100 percent of the premiums paid for a health insurance policy.”

Increased cost of administration:

Minnesota law currently requires insurance companies to pay out 82 percent of premium dollars to providers under small group plans, but only requires a payment of 72 cents per dollar for individual plans.

The reason that the admin cost of group plans is 36 percent less than individual plans is simple: It costs more to administer individual plans. As more people move to individual plans, fewer premium dollars will be available to pay providers.

Since state runs the Exchange, it must also somehow be compensated for its administrative costs. The Exchange law, as originally proposed, specified a two percent administrative cost to be added by the state on top of that which is built into the plans. This money can only come through increased premium or increased taxes: It is not cost neutral.

Individual health plans have fewer state-imposed insurance mandates. This allows premiums to be adjusted downward, and that may be a good thing: Another desirable option would be to reduce the number of mandates on group insurance, and thereby, reduce premiums.

A Mandate is Inevitable:

The only available tool available for an Exchange program to be “successful” is to mandate that all employers must provide a health insurance plan, and to dictate the benefit set of that plan. Or as an option, mandate that all individuals must own health insurance.

⁶ See note 1.

The benefit set, as conceived in Exchange legislation, is determined by an unelected board that is by its nature, unrepresentative of the state's residents. It would be impossible practically and politically to establish a neutral board, one that is broad enough to represent all interests, and insulated from political pressure to continuously enrich the benefit plan. Only the free market can regulate these choices.

The mandate does nothing to effect the plight of the unemployed or underemployed person, save to add them to the public health insurance system. In any event, at least two percent will stay outside the system.

The Alternative to the Exchange Requires Simplicity

To reduce the uninsured rate in a productive and realistic manner means reducing the cost of health insurance. Health insurance cost is a reflection of health care spending. Health care spending will only abate if people use fewer health care services. There are three ways to reduce overutilization of health care services:

1. Smarter health care spending (consumerism)
2. Healthier people.
3. Government rationing.

The Exchange fails to address the first and second concerns. Over time, however, it will lead to government rationing. Some leaders prefer this solution, or see it as inevitable.

Consumerism, on the other hand, means that insurance premiums will be reduced immediately, and that people develop smarter ways to spend health care dollars. Using HDHPs, even for those with most chronic conditions, can limit out of pocket expenses to a more management level.

Consumerism will directly and positively address the overall cost of health care. It will also encourage people to take better care of themselves. And these two facts will have the overall effect of reducing or flattening out of health care and health insurance cost.

Any reform plan that ignores the way that humans make purchasing decisions is destined to fail, and on this basis alone, it is enough to reject the Exchange.

ⁱ Greg Dattilo and Dave Racer are co-authors of *Your Health Matters: What you need to know about US health care*, and *FACTS: Not Fiction-What really ails US health care*. Alethos Press LLC, St. Paul, MN.
www.freemarkethealthcare.com.