CALIFORNIA HEALTHCARE FOUNDATION

Insurance Markets

Health Benefit Costs: Employers Share the Pain

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TRENDS & ANALYSIS

Introduction

California employers, like those throughout the United States, define the health care choices for most of the insured population. In recent years, however, soaring health care costs have forced employers across the state to make major changes in their health benefit plans. What will these changes mean to California? Two surveys — one of California employers and one of U.S. employers — conducted by Harris Interactive Inc.® on behalf of the California HealthCare Foundation — show how employers are attempting to contain costs and suggest some implications for employees. This report highlights key findings from this research and compares California's experience with the country as a whole.

A Sense of Urgency

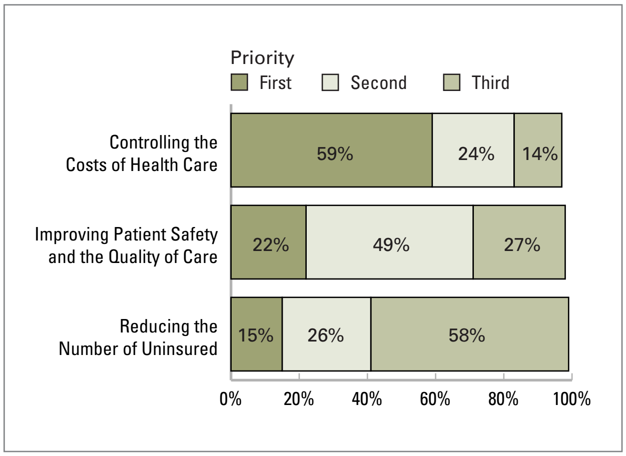
California employers expect health benefit costs to increase 14 percent on average in 2003; an overwhelming number (88 percent) agree that health care premiums will increase at double-digit rates for at least the next three years. Against this bleak backdrop, 53 percent of California employers offering health insurance describe their health benefit costs as "out of control," a slightly higher proportion than employers nationwide (48 percent) (see Table 1). California employers with fewer than 100 employees are particularly anxious about their health care costs. These employers are three times as likely as large employers (1,000+) to say their health care costs are totally out of control.

Table 1. Employer Assessment of the Inflation of their Health Benefit Costs

	EMPLOYERS	California, by Size			
INFLATION LEVEL	U.S.	All	Small	Medium	Large
Completely Under Control	6%	6%	5%	6%	6%
Somewhat Under Control	46%	41%	27%	38%	48%
Somewhat Out of Control	35%	41%	47%	38%	39%
Totally Out of Control	13%	12%	21%	16%	7%

Given these findings, it is no surprise that California employers are focused on cost-containment. Asked to rank the priority of three health-policy goals, most California employers selected cost control as their top choice (59 percent); almost one-quarter ranked improving patient safety and the quality of care as the highest priority, and just one in seven employers ranked reducing the number of those without health insurance as the top priority (see Figure 1).

Figure 1. Ranking of Priority Among Three Health Care Goals by California Employers



The Response So Far

When health insurance premiums began to escalate in the late 1990s, the tight labor market inhibited employers from passing along these costs to their employees. But as unemployment has grown and corporate profits have fallen, employers across the nation and in California have begun to shift a greater share of health care expenses to employees. In the past year, 57 percent of employers nationally and 44 percent of California employers increased employee cost-sharing, for example, charged more for each doctor visit or prescription filled (see Table 2). In addition, 17 percent of California and U.S. firms reduced the range of benefits covered by their health plans.

What's Next

With costs expected to continue to rise, California employers plan additional cost-sharing measures in the next two years. Two-thirds are likely to increase employees' share of costs at the point of service (see Table 3). Most employers also expect to increase premium contributions for dependents as well as employee-only coverage. Nearly three in ten will reduce the scope of covered benefits, and one-quarter plan to move toward a contingent workforce (part-time, temporary) without health benefits. However, less than ten percent plan to drop health coverage altogether. Overall, California employers' planned response is similar to employers nationally—although California employers are somewhat less likely to plan premium contribution increases for employee-only coverage and are substantially less likely to plan premium contribution increases for dependent coverage.

Contrary to popular perception, small employers in California are much less likely than medium- and large-sized employers to have shifted costs to their employees in the past year, and are less likely to plan future increases in employees' share of costs and premiums. In part, this may be due to health plan-

Table 2. Employers Who Made Each Health Benefit Change in the Past Year

	EMPLOYERS				
		California, by Size			
BENEFIT CHANGE	U.S.	All	Small	Medium	Large
Increased the amount of employee cost sharing	57%	44%	36%	48%	46%
Increased the premium contribution for employee-only coverage	N/A	39%	29%	46%	41%
Increased the premium contribution for dependent coverage	N/A	31%	15%	39%	35%
Reduced the scope of covered benefits	17%	17%	14%	21%	16%

Note: Data on premium contribution increases is not comparable between the U.S. and California because the U.S. survey did not collect premium contribution data separately for employee-only and dependent coverage.

Table 3. Employers Likely to Make Each Benefit Change in the Next Two Years

BENEFIT CHANGE	EMPLOYERS U.S.	California, All	California, by Size: Small	California, by Size: Medium	California, by Size: Large
Increased the premium contribution for employee-only coverage	73%	54%	33%	58%	60%
Increased the premium contribution for dependent coverage	68%	62%	48%	63%	69%
Increased the amount of employee cost-sharing	67%	66%	42%	70%	74%
Significantly restrict or reduce the prescription drug benefit	35%	29%	18%	23%	36%
Decrease the scope of covered benefits	29%	28%	21%	25%	31%
Employ more contract, temp, or part-time workers and not provide them with coverage	30%	25%	21%	25%	26%
Drop some or all of coverage for employees' dependents	7%	9%	8%	10%	9%
Drop some or all of coverage for employees	7%	9%	9%	10%	8%

imposed minimum participation requirements. These rules protect health plans from adverse selection (the risk that a disproportionate share of sicker employees will enroll in a given plan) by requiring the majority (usually 75 percent) of a policyholder's employees to participate in the health plan (or have insurance from another source). The need to keep take-up rates high inhibits many small firms' ability to tamper with their health benefits; if too many employees opt out of the employer-sponsored plan in response to cost increases, the entire firm could lose its coverage.

Although employers are shifting more costs to their employees, few have radically restructured their health benefit plans. That may change if one much-discussed new program, health reimbursement arrangements (HRAs) catch on. Typically employers couple an HRA with a lower-premium health plan that requires employees to meet high deductibles. The HRA works much like a traditional flexible spending account (FSA), reimbursing employees for out-of-pocket medical expenses through a tax-free account. One key difference is that a flexible spending account is funded by employee dollars, while an HRA is funded by employer dollars.

Furthermore, unused dollars in an employee's HRA account may be rolled over to the following year — a big improvement on FSAs. However, there is a catch. If employees' expenses exceed their HRA account balance, they are on the hook for 100 percent of their medical expenses until they reach their annual deductible. Thus, employees have incentives to spend their own health care dollars wisely.

Overall, a tiny fraction of California employers (two percent) currently offer such plans. And in spite of tremendous attention in the media and policy arenas, only ten percent of employers not currently offering an HRA plan say they are likely to offer this benefit in the next two years.

Nor are many employers embracing other strategies to encourage more cost-conscious choices among their employees. Only 28 percent of employers currently offer a defined contribution plan, in which the employer's premium contribution is fixed, either to a specific dollar amount or to the lowest cost plan offered, and the employee pays the difference between the cost of their chosen health plan and the employers' contribution.

Implications for Workers

Many consumer advocates and policymakers fear that higher out-of-pocket costs will cause consumers to go without needed medical care. Employers share these concerns. Solid majorities of California employers agree that increasing the cost of health services to consumers will cause some to forgo needed care and threaten the health of chronically ill workers. California employers are somewhat more concerned about these effects than are employers nationally (see Table 4).

Employers balance these concerns with the belief that when employees pick up more of their health care expense, they will spend more carefully on health care services and reduce unnecessary use of physician services and prescription medications. Fifty-two percent of California employers agree with the statement, "Health care costs will never be controlled unless consumers are forced to pay more out of their own pocket at the point of care." Thus, increased cost-sharing is seen as a business necessity, and is likely to become a fixture of employer-sponsored health plans.

Table 4. Employers that Strongly or Somewhat Agree with Potential Effects of Higher Cost Sharing at the Point of Care

EFFECTS OF INCREASED COST SHARING	EMPLOYERS U.S	EMPLOYERS CA
Positive Effects: Force consumers to spend more wisely on health care services	82%	83%
Reduce unnecessary doctors visits	78%	77%
Reduce unnecessary prescriptions	70%	65%
Harmful Effects: Cause consumers to forgo needed medical care	64%	70%
Have a negative impact on the health of employees with chronic conditions	61%	69%
Reduce the productivity of workers	34%	26%

Conclusion

Like their national counterparts, California employers are grappling with increasing health care cost inflation and expect those costs to continue to rise. Employers in the state have responded by increasing employees' share of out-of-pocket expenses and premium contributions — though these increases have been less pervasive in California than elsewhere. Despite the gloomy outlook on costs, only a handful of employers are currently offering "consumer-directed" health plans such as HRAs. (A Trends and Analysis report on consumer-directed health plans will be available on www.chcf.org in August.) Fewer than ten percent are considering dropping coverage in next two years.

Many employers are caught between the need to control health benefit costs and a desire to protect their employees from large medical bills. However, many agree that greater cost sharing will reduce necessary care and negatively affect employees with chronic conditions. Such outcomes should concern public policymakers as well.

Methodology

Results for U.S. employers are based on a 20-minute telephone survey with a nationally representative sample of 301 employers conducted between May 15 and June 5, 2002. The sample consisted of U.S. companies with five or more employees, excluding SIC Codes 80 (health services), 82 (education services), and 91–99 (public administration). The sample was stratified by employee size to ensure proper representation of each size company in the United States.

California data are based on a 20-minute telephone survey of 301 employers conducted between November 14 and December 24, 2002. The sample consisted of companies with five or more employees, excluding SIC Code 91-99 (public administration). For reporting purposes, employers were categorized into three employee-size categories: Small (5–99 employees); medium (100–999 employees); and large (1000 or more employees). The data were weighted by employee size to reflect the distribution of each size company in California.

FOR MORE INFORMATION

Additional data and information is available at www.chcf.org. A companion Trends and Analysis report, titled "Ready or Not: Consumers Face New Health Insurance Choices," focuses on the impact of health benefit trends on consumers and is also available at www.chcf.org.

Future editions will identify trends in California's insurance markets, analyze regulatory and policy issues, and provide industry updates. Analyses will be posted as they become available at the California HealthCare Foundation's Web site at www.chcf.org.

The California HealthCare Foundation's program area on Health Insurance Markets and the Uninsured seeks to improve the functioning of California's health insurance markets, particularly the small group and individual markets, and to expand coverage to the uninsured. For information on the work of Health Insurance Markets and the Uninsured, contact us at **insurance@chcf.org**.