

American Medical Association

Physicians dedicated to the health of America



Rethinking Employment-based Health Benefits

Enabling Consumer-driven Health Care

How a defined-contribution

approach to employment-based

health benefits can expand

consumer choice

and improve our

health care system

American Medical Association
Health Policy Group

Enabling Consumer-driven Health Care

Since the end of World War II, the United States has relied primarily on a private, employment-based system to provide health insurance

Today, about two-thirds of non-elderly Americans (those aged 64 and younger) are covered for medical expenses by an employer benefit plan. Thus, employment-based benefits are the source of health coverage for a large majority of Americans.

As times and conditions changed in the latter part of the 20th century, our traditional employer-based system of health insurance is serving us less and less well. For example, most of the uninsured US population without health coverage is employed.

The satisfaction of those who are covered by employer-provided health benefits is eroding. Many of the methods used to control costs by managed care plans, which is the dominant mode of employer-provided health benefits, have precipitated a public backlash against managed care in the form of legislated constraints on its ability to impose many cost-saving measures. The politicization of the system is clearly illustrated by the fact that the rights of patients in managed care plans was a significant factor in the state and congressional elections of 1998, was a volatile political issue in the 106th Congress, and promises to continue to be a highly contentious issue in the 107th Congress to be seated in 2001.

The design of our employment-based system of health benefits in the United States needs to be reconsidered. The system can be greatly improved by giving employees more health benefit options

and more freedom to choose coverage that more closely matches their needs. Giving employees more choices and freedom to choose will allow a consumer-driven system to displace the current employer-driven system. This will be good for both employees and employers as well as those who currently have access only to the market for individual health insurance policies.

What's Wrong With Our Current System?

*Individuals
lack choice*

Only 17 percent of employers providing health benefits offer their employees a choice between two or more health plans [RWJF, 1997]. Conversely, less than one-half (41 percent) of employees who are offered coverage by their employer can choose among two or more plans. This means that the majority of employees are offered, on a take-it-or-leave-it basis, a one-size-fits-all health plan chosen by their employer.

*Employers
give employee
satisfaction
a low priority*

Employers have a clear conflict of interest when choosing health plans for employees, since profit is the ultimate objective of business and benefit expense subtracts from profit. According to the latest (1999) Milliman and Robertson survey of human resources and employee benefit managers, 43 percent of employers view cost as the most important criterion for selecting health plans. In contrast, only 4.5 percent view employee satisfaction as the most important consideration, and less than 1 percent view quality of care as most important. Only 21.5 percent of employers survey workers on their

satisfaction with health care benefits, and 87 percent of surveyed employers said they would look for a new plan if premiums for a currently offered plan increased 3 percent or more.

When employees have limited choice of health plan, little if any pressure is felt by plans to be responsive to consumer interests. When employees cannot switch to another plan if they are dissatisfied with their current plan, market incentives for plans to compete on the basis of satisfying consumers are absent.

*Plans are not
responsive
to patient needs*

The restriction of plans offered to employees restricts the physicians and other health care providers available to employees. The services of some types of providers may not be covered, certain pharmaceuticals may not be covered, and the emphasis of managed care on cost has sometimes resulted in denial of payment for necessary medical care.

*Access to care
is restricted*

Employment-based health coverage is also inherently unstable. A survey conducted by the Commonwealth Fund found that almost one-half of the individuals surveyed changed plans in the last three years, most involuntarily because their employer changed plans or because they changed jobs. Forty-one percent of those changing plans reported having to change physicians. Such instability does not foster the development of beneficial long-term patient-physician relationships and could endanger the continuity of care many people receive.

*Employees
are forced to
change plans
too often*

How Will Consumer-driven Health Care Improve the System?

Expanding consumer choice can improve our health care system in many ways.

*Force plans
to work in
consumers'
interests*

Expanding health plan choices would force plans to compete for enrollees on the basis of service to consumers and to emphasize consumer satisfaction as a top priority.

*Increase consumer
satisfaction*

A Commonwealth Fund survey found that individuals whose employers offered only a single managed care plan reported consistently lower ratings of their plan with regard to quality of service, choice of physicians, access to specialists, accessibility of emergency services, and out-of-pocket costs than those in managed care plans who could have chosen another plan.

*Provide better
matches to
individual needs*

A one-size-fits-all health plan will provide too much or too little of particular kinds of coverage to most employees. For example, a 1999 survey sponsored by the Employee Benefit Research Institute found that 21 percent of workers would trade a reduction in their employer-provided health benefits for increased employer contributions to a pension plan, while 35 percent would trade a reduction in employer contributions to their pension plan in exchange for increased health benefits. Thus, benefits are mismatched for more than one-half of all employees. A wider choice of health plans would allow individuals to choose plans that better matched their particular needs and those of their families.

If individuals find that their health plan is not responsive to their interests or that the plan does not perform as expected, they could switch to more responsive plans. In contrast to employers, individuals experience health plan quality directly and can be expected to respond faster to differences in plan quality. Under a consumer-driven system, their ability to vote with their feet and pocketbooks would be significantly enhanced.

Let individuals leave unsatisfactory plans

How Can We Shift to a Consumer-driven Health System?

Employers will not expand the choices they offer employees within the current benefit system for many reasons. Most importantly, adding an additional health plan to the plans already offered employees is prohibitively expensive for most employers using current methods of benefits management. Most employers offering health benefits contract directly with health plans for services. The process of reviewing alternative products offered by different plans, negotiating coverage and cost, and monitoring plans' performance is costly and time-consuming.

Current benefit approach cannot accommodate an expansion of choice

Expanding choice will depend on employers' adopting a new approach to providing health benefits to employees. The approach that many think is the wave of the future involves conversion of benefit plans to a "defined contribution." Under the defined contribution approach, the employer would agree to provide a specific amount of money to the employee toward the purchase of health coverage from any source agreed upon by the employer and employee.

*A new approach—
"defined contribution"
—is coming*

*Tax law already
permits defined-
contributions*

The sources could include the employer's own benefit plan. The sources could also include plans outside the employer's benefit plan. In this case, Revenue Ruling 61-146 provides methods that the employer can reimburse employees for a share of premiums they pay for health insurance to retain the exclusion of the contribution from the gross income of the employees under section 106 of the Internal Revenue Code.

*The Internet
will be the
technological
basis for defined-
contribution
systems.
Internet-based
services will
expand choices*

The defined contribution approach can potentially expand health care choices by facilitating employee access to insurance products available outside the traditional employer benefit system. A number of developments are already occurring in the health insurance market to expand the number of products available at reasonable prices.

Industry analysts see the Internet playing a major role in expanding options that employers will make available to employees as part of defined contribution programs. The Internet has the potential to transform the way health benefits are provided by:

- Presenting employees with a number of options from many different vendors in a centralized internet location.
- Allowing employees to tailor their coverage in terms of premium, deductible and copayment, coverage of preventive and other extra services, freedom to choose physicians, and adjunct financial products such as Medical Savings Accounts and Flexible Spending Accounts.
- Providing consumers with information and algorithms to help them choose among plans as well as interact with the plans they choose in choosing physicians, making appointments, and communicating with their physicians.

Industry analysts also believe that Internet-based benefit systems can significantly lower the cost of non-employer-based coverage. Some of the factors that are projected to lower cost are:

- Expanding the pooling of risk to include employees of multiple employers and achieving economies of scale.
- Reducing plans' selling costs and employers' expenses for benefit consultants and administration of health benefit plans.
- Some argue that significantly expanding the pool of insureds in the individual market will make the expense of underwriting (ie, determining each individual's risk class and charging premiums accordingly) more costly and troublesome than it is worth so that insurers will ultimately abandon most underwriting practices.
- Stimulating a migration from prepayment toward true insurance that will reduce the amounts consumers pay to process small, recurring health care bills through third parties.

Internet-based services can improve the efficiency of insurance markets and lower coverage cost

Anticipating the movement from defined benefit to defined contribution employer-provided health benefits, a number of Internet-based online health insurance choice systems are under construction. Entrepreneurial ventures based on employers' defined contribution toward employees' purchase of health plans reflect a wide-spread belief that it is only a matter of time before defined contributions begin to displace the traditional employer health benefit system.

What Needs to be Done?

A number of employers have announced a desire to switch to defined contribution health benefits systems, but have met resistance from employees. Many employees think that health benefits are “free” under the current system and that they will have to start paying for their benefits under a defined contribution approach.

Economists agree that the common perception held by employees that their health benefits are free is misinformed. In reality, health benefits are part of employees’ total compensation. Consequently, employees experience a trade-off between wages or salaries and benefits without being explicitly aware of it. Furthermore, research has shown that older employees, who typically have higher health expenses, pay for them in terms of lower raises than their younger counterparts.

In today’s tight labor markets, employers need to deal with any employee concerns about a defined contribution health benefit before adopting such a system. Employers must educate their employees about how they can be better off under a defined contribution program, as well as set up the program so that employees can actually realize the promised improvements. The benefits lie in the dimensions of expanded options more closely aligned with individual employee needs, improved provider responsiveness to employees’ needs, less vulnerability to employers’ changing health plans and less interference from third parties in medical decisions, and ability to switch to more responsive plans. Another major advantage of defined contribution that will accrue to employees is “portability”—the ability to retain most coverage and provider relationships upon changing employers.

Notes

