

# Background

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## Making Association Health Plans a Success

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President George W. Bush wants to expand health care coverage for Americans and their families. A key part of his agenda would allow small-business owners to join together through trade and professional associations to purchase health insurance for themselves and their employees through arrangements known as association health plans (AHPs). Beyond these traditional AHPs, President Bush would encourage other, non-employer groups such as community, civic, charitable, and religious organizations to form associations—expanded AHPs—based on individual membership.

Both the traditional AHPs and the proposed expanded AHPs would be amenable to insurance pooling and purchasing techniques that would increase available coverage options. If done correctly, and in combination with other efforts, they have the potential to help transform today's health care system into one that is more consumer-oriented.

However, Congress should recognize that AHP arrangements alone would not fix today's health care system. Policymakers must also address the stark inequity in the current tax treatment of health insurance. Today, federal and state tax codes permit excluding the value of the coverage obtained through the workplace from an employee's taxable income, which benefits workers with higher incomes more than it benefits those with lower incomes. In 2004, the federal tax benefit alone associated with the current exclusion is estimated at \$188.5 billion.<sup>1</sup> Moreover, workers who purchase coverage outside their place of work do not receive a comparable tax benefit.

### Talking Points

- AHPs and other pooling arrangements would expand coverage options and have the potential to transform today's health care system into one that is more consumer-oriented.
- Traditional AHPs—those based on small business membership—still have the same limitations of employer-sponsored coverage in that workers would still have little involvement in and control of their health care decisions.
- The expanded AHP model based on individual memberships would empower individuals to choose and own their health care and also help promote continuity in coverage.
- But expanding health insurance coverage options is not enough. Policymakers must also tackle the tax treatment of health insurance to ensure that individuals are able to choose, without bias from the tax code, the best source of health care and coverage for themselves and their families.

This paper, in its entirety, can be found at:  
[www.heritage.org/research/healthcare/bg1824.cfm](http://www.heritage.org/research/healthcare/bg1824.cfm)

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Therefore, in order to transform the health insurance markets into a consumer-based system, it is vital that policymakers not only expand coverage options, but also restructure the tax code to ensure that neither federal nor state officials discriminate against an individual's choice in coverage.

### A New Policy

The AHP pooling concept would certainly expand the health care coverage options available to employers and individuals. Other group-pooling arrangements, such as statewide or multi-state arrangements, could also be of value.

In addition, the design of these pooling arrangements is important. Policymakers should encourage these arrangements to adopt a consumer-oriented approach based on competition, consumer choice, and a light regulatory regime. At the very least, policymakers should not preclude innovative designs by imposing legislative restrictions or requirements that stifle the emergence of a robust insurance marketplace.

Furthermore, combining these pooling arrangements with tax changes can help to transform the health care system. Ideally, the current employer tax exclusion should be replaced with a fairer system, such as a national system of individual tax credits.<sup>2</sup> At a minimum, Congress should extend refundable tax credits to low-income individuals who are without employer-based coverage and create opportunities for employers to provide a direct subsidy—a defined contribution—to employees who purchase their own health care coverage.

### Why Association Health Plans Are Attractive

Traditional AHPs emerged as a means for small businesses to address the growing difficulties in obtaining affordable health care coverage for themselves and their employees. Skyrocketing premiums, due in part to heavily regulated state insurance markets, have made obtaining health insurance an extremely costly benefit for small businesses, pricing many out of the market. In 2004, small businesses with fewer than 50 employees experienced a 13 percent increase in premiums.<sup>3</sup>

Under traditional AHPs, small businesses would purchase health insurance for themselves and their workers by banding together through bona fide trade and/or professional associations. These associations would be able to organize and negotiate health insurance on a federal level on behalf of their members. The Administration also proposes using small-business AHPs as a model for other groups—such as community, civic, and religious organizations—to offer coverage to their individual members.<sup>4</sup> Proponents argue these efforts will lower the cost of health insurance by creating alternatives for individuals and small businesses to purchase more affordable health care coverage.

AHPs appeal to small businesses, as well as to other groups and individuals, for a variety of reasons. Many hope they will achieve advantages similar to those of large employer groups. Two key advantages that AHPs aim to replicate are:

- **Larger pools.** One of the benefits of a large employer arrangement is its size, specifically

1. John Sheils and Randall Haught, "The Cost of Tax-Exempt Health Benefits in 2004," *Health Affairs*, Web exclusive, February 25, 2004, at [content.healthaffairs.org/cgi/reprint/hlthaff.w4.106v1](http://content.healthaffairs.org/cgi/reprint/hlthaff.w4.106v1) (January 28, 2005).
2. Analysts at The Heritage Foundation have long championed a comprehensive and universal reform that would replace the existing tax structure with a national system of tax credits. See Stuart Butler, "Reforming the Tax Treatment of Health Care to Achieve Universal Coverage," in Jack Meyer and Elliott Wicks, eds., *Covering America: Real Remedies for the Uninsured* (Washington, D.C.: Economic and Social Research Institute, 2001), pp. 21–42, at [www.esresearch.org/RWJ11PDF/full\\_document.pdf](http://www.esresearch.org/RWJ11PDF/full_document.pdf) (January 28, 2005).
3. Kaiser Family Foundation and Health Research and Educational Trust, *Employer Health Benefits 2004 Annual Survey* (Menlo Park, Calif.: Henry J. Kaiser Family Foundation, and Chicago, Ill.: Health Research and Educational Trust, 2004), p. 19, at [www.kff.org/insurance/7148/loader.cfm?url=/commonspot/security/getfile.cfm&PageID=46288](http://www.kff.org/insurance/7148/loader.cfm?url=/commonspot/security/getfile.cfm&PageID=46288) (January 28, 2005).
4. The White House, Office of Communications, "Fact Sheet: President Bush's Plan to Make Health Care More Affordable," January 26, 2005.

the size of its insurance pool. Larger pools spread the insurance risk across a greater number of people, with the result that younger and healthier people share in the cost for the older and sicker.

An AHP would attempt to recreate the large-pool concept by pulling together either small businesses, in the case of traditional AHPs, or individuals, in the case of the expanded AHP arrangements. Proponents argue that with a larger pool, these associations would also be able to leverage the size of their pool when negotiating with insurers and could reduce some of the administrative costs that small businesses and individuals face when purchasing coverage on their own.

- **Preemption of state regulation.** Another benefit of large employer arrangements is its regulatory structure. Most large employer arrangements are regulated by the federal Employer Retirement Income Security Act (ERISA). This act preempts state law and establishes basic federal rules for large employer arrangements.

Today, insurance policies purchased by small businesses and individuals are regulated by the states. Disappointingly, many states have adopted well-intentioned but costly regulations that make coverage unaffordable for many small businesses and individuals.<sup>5</sup> Under the proposal, AHPs would be federally regulated, preempting state regulations and establishing basic standards similar to those put forth by ERISA.

### Where the Traditional AHP Model Falls Short

While traditional AHPs (those based on small businesses pooling together to purchase coverage for their employees) would offer small businesses

a new coverage option, the current limitations of employer-sponsored coverage would still exist. The lack of individual ownership, personal choice, and true portability are all obstacles to moving toward a more robust consumer-based health care system.

Employers with insurers would still determine the benefits package and decide what is and is not covered, dictate the cost-sharing arrangements for individuals and families, and hold the contract with the insurance companies. Moreover, under an exclusive employer-sponsored system, the employer also determines the types and number of policies available to employees, whether they are PPO (preferred provider organization), HMO (health maintenance organization), or fee-for-service plans.

In the case of AHPs, employers would simply transfer these decisions to the AHP organizers. AHP organizers would try to devise an arrangement that reflects the needs of multiple employers. The final judgment of the plan's quality and performance, as well as the adequacy of its benefits, would remain in the hands of the employer and the AHP organizers, not the workers.

Finally, in an employer-based system, the lack of portability and ownership still persists. Each time workers leave jobs, they lose their health insurance. Unlike decades ago, fewer and fewer workers stay at the same job for their entire lives. Thus, over a lifetime, a system dominated by employer coverage perpetuates involuntary gaps and changes in coverage that disrupt and discourage continuity in care.

### The Advantages of an Open AHP Model

The President's proposal to expand the traditional AHP concept beyond the employer-based system to other organizations—such as community, civic, and religious groups—would move the

5. Policies such as the combination of guaranteed issue and strict community rating, which requires an insurer to sell to all applicants without varying premiums, and excessive and costly mandates, which require an insurer to cover specific benefits and services. For a full discussion of these issues, see Council for Affordable Health Insurance, "Eliminate Guaranteed Issue," *Covering the Uninsured Week* Solution No. 2, May 11, 2004, at [www.cahi.org/article.asp?id=225](http://www.cahi.org/article.asp?id=225) (January 28, 2005), and Victoria Craig Bunce and JP Wieske, "Health Insurance Mandates in the States, 2005," Council for Affordable Health Insurance, January 2005, at [www.cahi.org/cahi\\_contents/resources/pdf/MandatePubDec2004.pdf](http://www.cahi.org/cahi_contents/resources/pdf/MandatePubDec2004.pdf) (January 28, 2005).

health care markets much closer to a more consumer-oriented system. It would offer individuals more choices and opportunity to find a health care arrangement that suits them and their families. Under these arrangements, groups could organize to offer health care coverage to their individual members, and individuals would be able to obtain health care coverage through a group or organization with which they are associated.

This type of arrangement would give individuals the ability to select coverage based on their personal needs. For example, an individual could choose to participate in a plan offered through a local civic or community group, or people could find faith-based health insurance plans offered through their places of worship that reflect their moral and religious beliefs.<sup>6</sup>

Furthermore, unlike employer-based coverage, individuals also tend to have longer-term relationships with individual membership organizations. Coverage through these individual member groups could help promote continuity in care and coverage as well as empower consumers to choose and own their health care policies.

### The Key Elements of a Successful Pooling Arrangement

In health policy, the crucial details of legislative proposals will determine their success. Based on a rich body of experience, it is clear that legislatively mandated design flaws can undermine or destroy a perfectly reasonable policy.

Expanding coverage options through such pooling arrangements as AHPs is essential to the transformation of America's health care system. The scope and design features of these arrangements are equally as important. Whether pooling arrangements are promoted at the federal level or designed and implemented at the state level, poli-

cymakers should ensure that the final product guarantees a robust system of consumer choice and competition.

Specifically, when developing strategies to create an effective consumer-based system, Congress and state legislators should consider the following options:

1. **Expanding the adoption of pooling arrangements.** Instead of focusing solely on AHPs, Congress should also encourage the development of other pooling arrangements. President Bush has suggested offering grants to states for the establishment of insurance pools.<sup>7</sup> Ideally, states could use these grants to create statewide pooling arrangements or even multi-state compact arrangements. This approach would still leverage the benefits of large groups, but would also offer an alternative to the federal preemption of state insurance laws—a major concern among critics. In place of federal preemption, states could establish a new, friendlier regulatory structure for these types of arrangements.
2. **Promoting greater consumer choice.** In designing an effectively functioning consumer-based pool, it is important to give participants the ability to select a plan that best suits their needs. Policymakers should ensure that AHPs and other pooling arrangements are able to offer the broadest variety of plan designs. Individuals should be able to choose the type of plan—whether a PPO, HMO, fee-for-service, health savings account (HSA), or another new and emerging health care delivery model—with which they feel the most comfortable.<sup>8</sup> Particularly in traditional AHP arrangements, the availability of HSAs, which allow individuals to own and accumulate funds in an account attached to a high-

6. For a detailed discussion of faith-based health insurance plans, see Phyllis Berry Myers, Richard Swenson, M.D., Michael O'Dea, and Robert E. Moffit, Ph.D., "Why It's Time for Faith-Based Health Plans," Heritage Foundation Lecture No. 850, August 24, 2004, at [www.heritage.org/Research/HealthCare/hl850.cfm](http://www.heritage.org/Research/HealthCare/hl850.cfm).

7. The White House, Office of Communications, "Fact Sheet: President Bush's Plan to Make Health Care More Affordable."

8. A health savings account combines a high-deductible health insurance plan with a tax-preferred savings account. For additional information, see [www.ustreas.gov/offices/public-affairs/has/](http://www.ustreas.gov/offices/public-affairs/has/).

deductible plan, would offer a degree of ownership in an employer-based system.

3. **Facilitating plan competition.** Another important feature of a consumer-based pool is ensuring that participants can choose not only from among a variety of plan designs, but also from among competing insurance companies. Encouraging competition would allow consumers to compare different plans and select a plan based on value, while insurers would adapt to consumer demand. Thus, the consumer would be responsible for judgments on the health benefit's quality, performance, and desirability. Policymakers should encourage such competition in these pooling arrangements.
4. **Establishing a light regulatory structure.** In designing a consumer-based pool, policymakers should resist attempts to overregulate these arrangements. It is important that these arrangements function much more like a business than a government health care regime. Genuine negotiation, not government mandates, and the economic rules of supply and demand should be relied upon to determine the success or failure of different plans' benefit packages.

## Conclusion

Association Health Plans, both traditional and expanded, would certainly improve coverage options for workers and their families in today's structurally flawed health care system.

Congress can make AHPs even more successful by advancing consumer-oriented mechanisms, such as competition, consumer choice, and a nimble regulatory structure. Congress should also consider developing other new pooling and insurance delivery options that encourage state officials to reform the structure of their insurance markets, change or modify their rules and regulations, and make their health insurance markets more affordable and appealing to individuals and businesses.

However, expanding health insurance coverage options is not enough. Policymakers must also tackle the tax treatment of health insurance. Policy changes must ensure that individuals are able to choose, without bias from the tax code, the best source of health care and coverage for themselves and their families.

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