

# **The Negative Impact of the Affordable Care Act on Small Employers and their Employees**

Statement for the Record

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“Reimagining the Health Care Marketplace for America’s Small Businesses”

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Chairman Chabot, Ranking Member Velázquez, and members of the committee, thank you for the opportunity to submit written comments about the impact of the Affordable Care Act (ACA) on small businesses and their employees. I am Devon Herrick, a senior fellow at the National Center for Policy Analysis. We are a nonprofit, nonpartisan public policy research organization dedicated to developing and promoting private alternatives to government regulation and control, solving problems by relying on the strength of the competitive, entrepreneurial private sector.

The Patient Protection and Affordable Care Act (ACA) inhibits the growth of small businesses by raising the cost of growing beyond a certain size. This is more pronounced for firms employing low-skilled workers. The ACA's employer mandate requires firms employing more than 49 workers to offer health coverage that includes an essential benefit package or pay a fine. The fine is \$2,000 per worker beginning with the 31st worker. For firms that do not offer health benefits, this means the marginal cost of hiring the 50th worker is \$40,000 in penalties on top of compensation costs for the 50th worker  $[(50 - 30) \times \$2,000]$ . Thus, small firms that employ less than 50 workers are unlikely to expand beyond 49 workers — especially if their workers are modest wage earners

As a 2015 *New York Times* article illustrated, this perverse incentive is hardly theoretical. The *Times* piece highlighted the dilemma of LaRonda Hunter, a hair salon entrepreneur from Fort Worth, Texas. Ms. Hunter owns four *Fantastic Sam's* hair salons and would like to open more. However, at 45 workers, opening another salon (employing, say, an addition 11 or 12 workers) would push her number of employees past the threshold where she would have to begin offering health benefits or pay a fine. This is something she claims would wipe out her profits and the salary she pays herself.<sup>1</sup>

The men and women who work for Ms. Hunter could be described as mostly lower-paid workers, most of whom presumably feel they cannot afford to spend, say, \$4,000 per year on health coverage. Health coverage through work is not merely a cost of doing business as some would have you believe. Health coverage is a noncash component of employees' total compensation.<sup>2</sup> Absent the ACA, Hunter would be largely unaffected whether or not her workers would collectively trade \$4,000 in pretax wages for \$4,000 worth of health coverage. The problem is: Her workers are not indifferent to whether she pays them less cash and buys them health insurance.<sup>3</sup> Her workers presumably would quit and seek work elsewhere if she ratcheted down their compensation and provided the health coverage the ACA requires. She could even run afoul of minimum wage laws if she paid her workers less so she could provide \$2 per hour worth of health benefits. Stated another way, employers don't pay for health benefits, workers do. To the extent employers are required to offer mandated benefits that workers are unwilling to pay for, the difference is a tax on labor that inhibits job creation. Even if workers are willing to pay, they may be unable to pay.

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<sup>1</sup> Stacy Cowley, "Health Care Law Forces Businesses to Consider Growth's Costs," *New York Times*, November 18, 2015.

<sup>2</sup> Joseph J. Martocchio, *Employee Benefits: A Primer for Human Resource Professionals, 2nd Edition*, McGraw Hill/Irwin: NY, 2005).

<sup>3</sup> Stacy Cowley, "Many Low-Income Workers Say 'No' to Health Insurance," *New York Times*, October 19, 2015.

Much of the cost of increases in mandated benefits for groups of workers, are paid for by the group itself in the form of lower wages and in some cases lower employment.<sup>4</sup>

In Ms. Hunter's case, she claims providing health coverage would erase her profit. My back-of-the-envelope calculations based on Ms. Hunter's account to the *New York Times* and some industry data suggests she would need to open two more salons and employ about 70 workers just to match the profits she now earns under the individual mandate threshold with about 45 workers.<sup>5</sup> If the average premiums for health insurance rises faster than her workers' productivity, over time workers would begin to cost more than they earned for her and each worker employed would add to her losses.

Firms that offer coverage also have to worry whether the coverage meets the federal definition of "affordable." Coverage that is deemed affordable cannot exceed 9.5 percent of workers' pay for self-only coverage. Employers must pay a penalty of \$3,000 for every worker whose coverage is not deemed affordable and who qualifies for and receives a subsidy in the exchange or enrolls in Medicaid.

In 2015 the National Labor Relations Board (NLRB) found certain contract workers are subject to the *joint employer* rules in instances where a staffing firm provides workers but another firm has nominal control over them. Being deemed a joint employer could have ramifications for ACA compliance.<sup>6</sup> At least in theory, a firm not currently subject to the employer mandate could be potentially subject to the employer mandate if its contract workers were found to be jointly employed.

The ACA costs jobs, reduces worker pay and foists other, higher regulatory cost on small firms. The American Action Forum estimated Obamacare led to job losses of about 300,000 workers and 10,130 fewer business establishments. In addition, the employees of small businesses are forgoing nearly \$20 billion in lost wages annually.<sup>7</sup> This is consistent with data from 2014. Rising health insurance premiums and additional regulations decreased pay in firms with 20 to 99 employees by more than \$23 billion annually. Workers in smaller firms, those with 20-49 employees, have experienced a decrease in real wages of more than \$800 annually.<sup>8</sup>

The Kaiser Family Foundation estimates that the required coverage for an individual cost an average of \$5,277 or more a year in 2016.<sup>9</sup> This is the equivalent of an additional \$3 an hour "minimum health wage." Family coverage could cost more than twice that amount. Employers are fined if they drop their health insurance plans altogether or if their health plans are deemed

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<sup>4</sup> Jonathan Gruber, "The Efficiency of a Group-Specific Mandated Benefit: Evidence from Health Insurance Benefits for Maternity," National Bureau of Economic Research, Working Paper No. 4157, September 1992.

<sup>5</sup> Devon Herrick, "Obamacare is a Job-Killer: Here's the Proof," *Town Hall*, November 23, 2015.

<sup>6</sup> Brian Nugent, "DOL's New Joint Employer Interpretation Seeks to Hold More Employers Accountable," Employers; Lawyers blog, February 2, 2016.

<sup>7</sup> Ben Gitis and Sam Batkins, "Update: Obamacare's Impact on Small Business Wages and Employment," American Action Forum, January 18, 2017.

<sup>8</sup> Ben Gitis, Conor Ryan and Sam Batkins, "Obamacare's Impact on Small Business Wages and Employment," American Action Forum, September 9, 2014.

<sup>9</sup> "2016 Employer Health benefits Survey," Kaiser Family Foundation, September 2016.

“unaffordable” to any of their employees. One perverse response to the employer mandate has been for small business is to reduce workers’ hours to part time because they are not required to offer coverage for employees who work less than 30 hours per week.

Finally, firms that offered coverage prior to the ACA still indirectly pay additional costs due to the Affordable Care Act.

- There are per member per month taxes on health plans. Further, an annual health insurance industry fee is thought to increase the cost of premiums by 3 percent to 4 percent.
- There was also a transitional reinsurance program assessment fee, which is phasing out, but which some firms will owe as late as November 2017.
- A 2.3 percent gross tax on medical devices was pushed back, but will increase the cost of the medical devices paid for by health plans beginning in 2018.
- The tax on brand drugs also will indirectly fall on health plans.
- In a few years the so-called Cadillac Tax could affect the level of benefits offered and increase the taxes on benefits. The tax is 40 percent of premiums in excess of \$10,200 for individual coverage and \$27,500 for family coverage.

In addition to the mandated benefits package, the coverage firms are required to offer their workers must also meet a strict criteria. For example, there can be no cap on annual or lifetime benefits. Firms must also accept workers’ adult offspring until the age of 26 and most benefits must include the essential benefit package mandated by the ACA. These regulations all make employee health coverage more costly than need be by precluding plans that are more affordable. Low-wage employers do not have the option of offering benefits less generous than Obamacare.

I conclude that the Patient Protection and Affordable Care Act has had a profoundly negative effect on many small businesses employing modest-wage workers. Fortunately, Congress has the opportunity to eliminate some of the problems caused by the ACA through the budget reconciliation process. Congress should start with repealing the employer mandate, or at least waive the fines and penalties. Congress should also repeal the individual mandate or change the parameters to make it less onerous on employers and individuals. Congress should explore whether or not some of the provisions can be modified to make health coverage less costly to small employers and their employees.

Thank you for the opportunity to submit comments.