



## Is employer-based health insurance a barrier to entrepreneurship?\*

Robert W. Fairlie<sup>a</sup>, Kanika Kapur<sup>b,\*</sup>, Susan Gates<sup>c</sup>

<sup>a</sup> Department of Economics, University of California, Santa Cruz and RAND, United States

<sup>b</sup> School of Economics and Geary Institute, University College Dublin, Ireland

<sup>c</sup> RAND, United States

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### ABSTRACT

The focus on employer-provided health insurance in the United States may restrict business creation. We address the limited research on the topic of “entrepreneurship lock” by using recent panel data from matched Current Population Surveys. We use difference-in-difference models to estimate the interaction between having a spouse with employer-based health insurance and potential demand for health care. We find evidence of a larger negative effect of health insurance demand on business creation for those without spousal coverage than for those with spousal coverage. We also take a new approach in the literature to examine the question of whether employer-based health insurance discourages business creation by exploiting the discontinuity created at age 65 through the qualification for Medicare. Using a novel procedure of identifying age in months from matched monthly CPS data, we compare the probability of business ownership among male workers in the months just before turning age 65 and in the months just after turning age 65. We find that business ownership rates increase from just under age 65 to just over age 65, whereas we find no change in business ownership rates from just before to just after for other ages 55–75. We also do not find evidence from the previous literature and additional estimates that other confounding factors such as retirement, partial retirement, social security and pension eligibility are responsible for the increase in business ownership in the month individuals turn 65. Our estimates provide some evidence that “entrepreneurship lock” exists, which raises concerns that the bundling of health insurance and employment may create an inefficient level of business creation.

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### 1. Introduction

The predominant source of health insurance in the United States for working-age adults is employer-provided health insurance. Nearly two-thirds of adults under age 65 and three-quarters of all full-time workers have health insurance through employers (U.S. Census Bureau, 2007). A potential cost of this reliance on employer-provide health insurance is the non-portability of insurance across employers potentially resulting in “job lock.” Workers may be reluctant to switch jobs when otherwise optimal because of the possible loss of coverage due to pre-existing condition exclu-

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\* Corresponding author. Tel.: +35317164624.

E-mail address: [kanika.kapur@ucd.ie](mailto:kanika.kapur@ucd.ie) (K. Kapur).

sions, waiting periods on new jobs, loss of particular insurance plans, and disruption in the continuity of care with their healthcare providers.

Concerns about disruptions in health insurance coverage could also influence the decisions of individuals who are contemplating starting new businesses (Holtz-Eakin et al., 1996). Such individuals who are currently covered by employer-sponsored health insurance would eventually lose that coverage if they leave their job. Potential business owners could face high premiums in the individual health insurance market and the possibly prohibitive health costs of being uninsured. Furthermore, changes in health plans and providers may be disruptive and costly. New entrepreneurs may also be exposed to pre-existing condition limitations and waiting periods for coverage if they have a spell of uninsured unemployment between their employer-provided coverage and their new health insurance policy.<sup>1</sup> Unless they have alternative sources of health insurance coverage, such as through a spouse’s employer,

<sup>1</sup> The 1996 Health Insurance Portability and Accountability Act (HIPAA) mandates that pre-existing condition limitations and waiting periods cannot be imposed on individuals who had continuous prior health insurance coverage, but it does not apply to individuals who do not have continuous prior coverage.

this health insurance conundrum may influence their decision to start a new business.

All of these factors suggest that the U.S. focus on employer-based health insurance may restrict the formation of new businesses and create the additional inefficiency of altering who becomes and who does not become an entrepreneur. Although concerns that health insurance costs are “killing new-business dreams” (Egerstrom, 2007; Keen, 2005) and that health insurance issues distort employment choices to the detriment of start-ups (Leonhardt, 2009; Baumol et al., 2007) have been voiced for several years, the issue has taken on a new salience with the passage of the Patient Protection and Affordable Care Act of 2010 (PPACA). In the debate leading up to the passage of PPACA, President Obama noted the concern:

This is something I hear about from entrepreneurs I meet – people who’ve got a good idea, and the expertise and determination to build it into a thriving business. But many can’t take that leap because they can’t afford to lose the health insurance they have at their current job.<sup>2</sup>

Under PPACA, states will create “exchanges” where individual consumers can purchase insurance, and insurers will not be able to apply pre-existing condition exclusions and price premiums based on health status.<sup>3</sup> Although these features of PPACA have the potential to weaken entrepreneurship lock, PPACA exempts existing health plans from most regulations potentially allowing disparities in the value of health coverage to persist for some time (Eibner et al., 2010).

Given these concerns, it is surprising that only a handful of studies have examined whether employer-provided health insurance limits business creation. The few studies in the literature find mixed results, with some estimating that health insurance reduces transitions into self-employed business ownership by as much as 25% and others finding no evidence that health insurance reduces business creation (Holtz-Eakin et al., 1996; Madrian and Lefgren, 1998; Bruce et al., 2000; Wellington, 2001; DeCicca, 2007). The lack of research on the topic contrasts sharply with a much larger literature that examines the effects of employer-provided health insurance on employer-to-employer mobility (see Gruber and Madrian, 2004, for a review).

In this paper, we address the lack of current research on the topic of “entrepreneurship lock” by providing a new study of whether the U.S. health insurance system impedes business creation. We use panel data created by matching consecutive years or months of the Current Population Survey (CPS) and two identification strategies to examine this question. First, following the identification strategy pursued in most analyses of job lock, we compare the probability of turnover of otherwise observationally equivalent employees who differ only in the value that they are likely to place on a current employer’s health insurance policy. We estimate difference-in-difference models for the transition from wage-based employment to self-employed business ownership as a function of access to alternative health insurance and family health. Individuals with no alternative means of health insurance who obtain health insurance from their own jobs, and individuals who have poor family health should be less likely to become business owners. Our preferred set of models restricts the sample to workers with employer-provided health insurance, and compares transitions of workers without access to alternative health insurance and with poor family health to those who have access to alternative health insurance and have good family health. The CPS allows us to measure business creation

of all types of businesses including incorporated, unincorporated, employer and non-employer businesses.

The second identification strategy exploits the abrupt change in health insurance coverage occurring at age 65 due to Medicare. The discontinuity in coverage suggests that a comparison of business ownership among individuals just below the age 65 cutoff to those just above the age 65 cutoff provides a test of the entrepreneurship lock hypothesis that is as close to a random experiment as possible. Although previous studies exploit the discontinuity in health insurance coverage created by Medicare (e.g. Card et al., 2008, 2009), the approach has not been previously taken to identify the effects of health insurance coverage on business creation. The lack of research on the topic may be due to the difficulty in finding a dataset with large enough sample sizes and a high-frequency measure of age. To address this problem, we use a novel procedure for identifying a person’s age in months from matching monthly data from the CPS. To our knowledge, this is the first study using this procedure for identifying age in months from the CPS and the first study using the discontinuity created by Medicare to test the entrepreneurship lock hypothesis. The results from this new identification strategy and the difference-in-difference approach using recent data shed light on the question of whether employer-based health insurance restricts business creation in the United States.

## 2. Previous literature

The few studies that examine the relationship between business creation and an individual’s health insurance coverage status find mixed results.<sup>4</sup> Holtz-Eakin et al. (1996) considered the effect of health insurance coverage status on transitions from employment to self-employed business ownership using the 1984–86 Survey of Income and Program Participation (SIPP) and the 1982–84 waves of the Panel Study of Income Dynamics (PSID). Their study used difference-in-difference models based on the notion that insured wage/salary workers who had families in poor health and workers who did not have access to spouse health insurance should be less likely to transition to self-employed business ownership. While their estimates were quantitatively large (a lack of health insurance portability stemming from employer-sponsored insurance reduced the probability of transition from employment to self-employment by 9–15% in the SIPP population), they were statistically insignificant. Therefore, the authors could not confirm that health insurance impeded transitions to business ownership. Madrian and Lefgren (1998) also examine the question using the SIPP and find that by using additional waves of SIPP data (1984–93), estimates of the effect of health insurance coverage status on transitions to self-employment attain statistical significance. In addition to using the difference-in-difference methodology used by Holtz-Eakin et al. (1996), they also use the passage of continuation of coverage mandates to identify the effect of health insurance coverage status on transitions to business ownership. Their estimates imply that a lack of health insurance portability accounts for a 25% reduction in business creation. In other work, Wellington (2001) uses a similar estimation methodology to analyze data from the 1993 Current Population Survey (CPS). The author estimates the impact of having health insurance through one’s spouse on the likelihood of self-employed business ownership. Her estimates suggest that a guaranteed alternative source of health insurance would increase the probability of business ownership between 2.3 and 4.4 percentage points for husbands and 1.2 and 4.6 percentage points for wives.

<sup>2</sup> [http://www.whitehouse.gov/the\\_press\\_office/Weekly-Address-President-Obama-Explains-How-Health-Insurance-Reform-Will-Strengthen-Americas-Small-Businesses/](http://www.whitehouse.gov/the_press_office/Weekly-Address-President-Obama-Explains-How-Health-Insurance-Reform-Will-Strengthen-Americas-Small-Businesses/).

<sup>3</sup> <http://www.allhealth.org/sourcebookcontent.asp?CHID=68>.

<sup>4</sup> The literature on the effects of an individual’s health status on entrepreneurship also find mixed results (see Parker, 2009).

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