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## Reasonable changes in employee health benefits could yield significant funds for next state budget

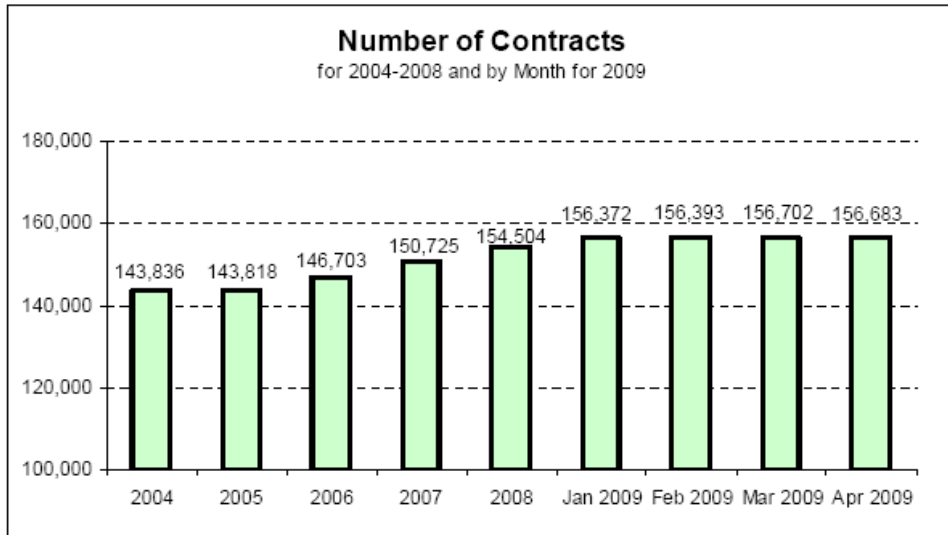
**FRANKFORT, Ky.** (Nov. 9, 2009) – State government has faced a record revenue shortfall in recent months, and prospects for the next budget are grim. Concerned about the impact of the state’s tight budget and spending patterns on education and other essential services, the Kentucky Chamber of Commerce has worked to identify areas of savings.

One such area is public employee health benefits. The Chamber has identified how reasonable changes to the state’s program could generate nearly \$200 million in additional funding for Kentucky’s 2010-2012 budget.

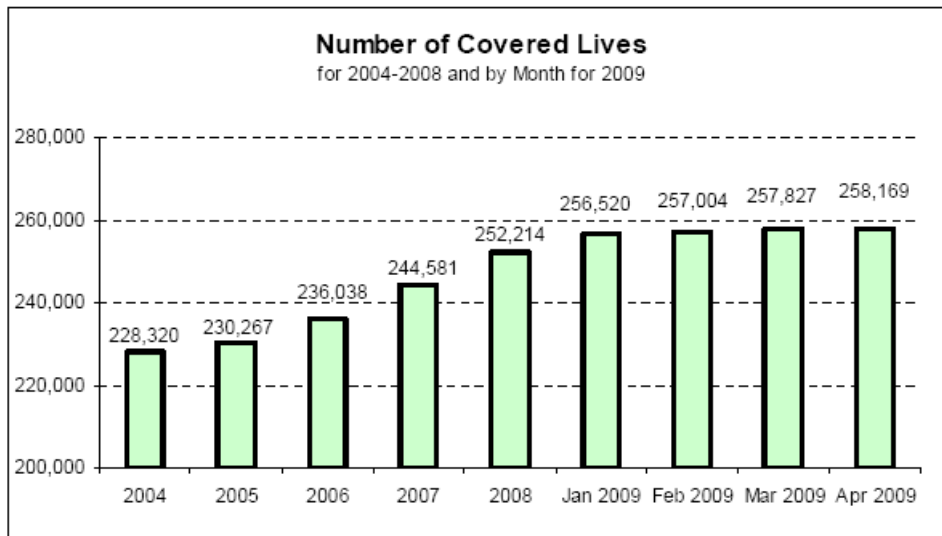
The Chamber’s research and recommendations are detailed below.

### The Problem

- **A Major Cost:** At a cost of more than \$1.2 billion a year, Kentucky state government pays monthly health premiums for 156,683 active state employees, state retirees and teachers (depicted as number of contracts in the graph below).<sup>1</sup> The Kentucky Employees Health Plan (KEHP) covers more than 6% of all Kentuckians – more than 258,000 teachers, state employees, retirees and their dependents (depicted as the number of covered lives in the graph on the following page).<sup>2</sup> More than 12% of Kentucky’s General Fund budget now goes to pay these premium costs.



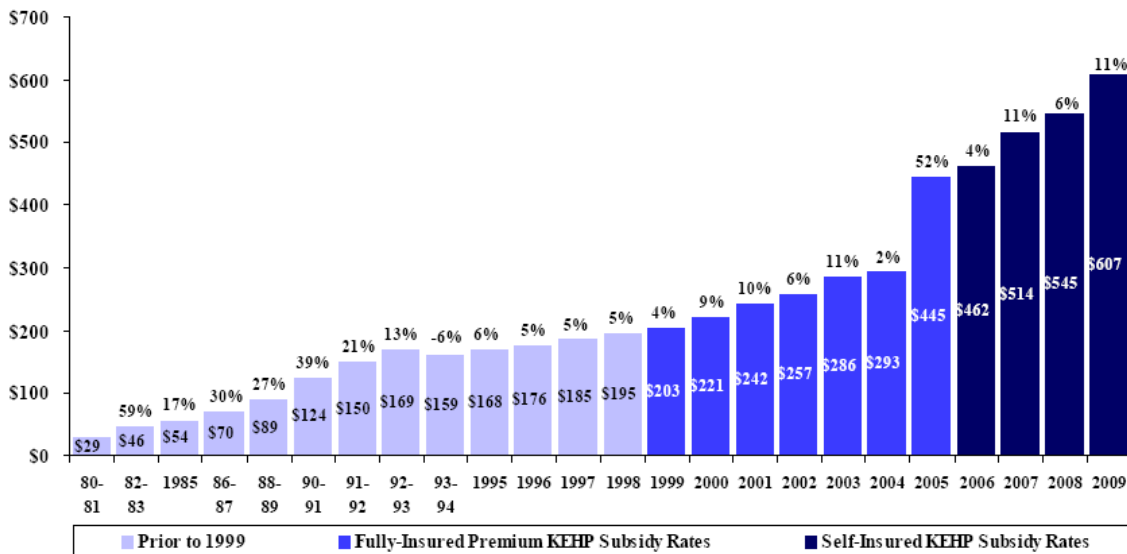
Source: Health Insurance Program Monthly Report, Kentucky Group Health Insurance Board, June 2009



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- Rate of Growth Unsustainable: State government's contributions for employee health insurance are growing at more than five times the rate of overall state spending.** According to recent research by the Kentucky Chamber, total General Fund spending has increased by 33% since 2000. During the same period, the state's average monthly per employee contribution for health insurance **has increased by more than 174%** —from \$221/month in 2000 to more than \$600/month in 2010 (\$7,284/year).<sup>3</sup>

**KEHP Monthly Health Insurance Subsidy Per Employee And Annual Percentage Increase: 1980-2009**



Source: Kentucky Employees Health Plan, Eighth Annual Report, October 2009

- Health Costs Major Driver of Pension Costs:** Retired public employees receive the same health benefits as active state employees in Kentucky. As a result, the cost of health care is a key driver of rising pension costs, accounting for 55% of state government's contributions to its pension system.<sup>4</sup> Kentucky's pension systems currently face unfunded liabilities of more than \$26 billion.
- KY Government Pays Higher Percentage of Premiums:** Kentucky exceeds the national average in the percentage of employees' insurance premiums that the state pays (97% vs.

88% nationally).<sup>5</sup> Meanwhile, private employers who offer health coverage in Kentucky (about 60% of all employers) pay an average of 80% of their employees' single-coverage premiums.<sup>6</sup>

- **Government Employees' Premiums Higher than Private Sector:** The Kaiser Family Foundation reports that the average monthly premium for Kentucky's private-sector employees in 2008 was \$344, or \$4,009 per year.<sup>7</sup> With a monthly premium of \$545 in 2009, the Kentucky Employee Health Plan exceeds the average private-sector cost by 58%.
- **State Salaries Higher than Average Kentucky Wages:** A frequently heard argument is that state workers earn less than those in the private sector. However, the average annual salary of a state employee was approximately \$38,000 in 2008-2009.<sup>8</sup> This is significantly higher than the average annual wage for all occupations in Kentucky, which is \$36,855, according to statistics compiled by the Kentucky Workforce Development Cabinet.<sup>9</sup>
- **Health Coverage Costs as a Percent of Salary:** With an average salary for state employees of \$38,000, the \$6,540 annual cost of health insurance in 2009 (which is paid in addition to salary) would be 17.2% of salary. In Kentucky's private sector, with an average annual salary of \$36,855, the \$4,009 annual cost of health insurance would be 10.8% of salary.
- **State Health Coverage Richer than Private Sector Plans:** There are a number of reasons that public health plans are more expensive than private sector plans:
  - Coverage levels tend to be richer in public plans.<sup>10</sup>
  - Co-payments, contributions and other sharing approaches are typically lower in public plans than in private plans.<sup>11</sup>
  - As noted earlier, governments pay a higher percentage of premiums on average than private businesses in Kentucky (97% for Kentucky state government vs. 80% for private employers in Kentucky).<sup>12</sup>

Here are two key examples from Kaiser Foundation's 2009 Survey of Employee Benefits that show how the Kentucky Employee Health Plan (KEHP) benefits are richer than the average health plan in America. The key factor is the amount of co-pays:

- Nationally, the average co-payment for a physician office visit is \$20, compared to a co-pay of \$10 to \$15 in the KEHP (depending on the plan chosen by the employee)
- Most health plans have a four-tier prescription drug benefit. The average co-payment for each tier is as follows:

	<b>National Average</b>	<b>KEHP</b>
Generic	\$10	\$5
Preferred	\$27	\$20
Non-Preferred	\$46	\$40
Fourth-tier	\$85	N/A

- **Priorities Shifting from Education:** Increased spending on public employee health benefits means fewer dollars are available for what should be Kentucky's top priority—education. In terms of the state budget, the share going to employee health costs is growing while education's share is getting smaller:
  - Since 2000, the percentage of the General Fund going to public employee health coverage has more than doubled—from 6.5% in FY 2000 to 12.5% in the current fiscal year.<sup>13</sup>

- K-12 education's share of General Fund appropriations has declined from a high of 48.2% in FY 1986-88 to 43.8% in the current fiscal year.<sup>14</sup>
- Postsecondary education's share declined from 16.9% in 1986-88 to 13.7% in the current fiscal year.<sup>15</sup>

The increased spending on public employee health benefits isn't entirely responsible for our shifting priorities. Growth in corrections and Medicaid also outpace overall government spending.

### Potential Solutions

The combination of escalating costs, generous subsidies, a looming state budget deficit, and the shift away from education funding raises serious questions about the long-term sustainability of the Kentucky Employees Health Plan. The Chamber believes the following strategies will lower costs and provide public employees with health coverage while bringing public benefits more in line with the private sector.

- **Require public employees to contribute a reasonable amount for health insurance:** As noted above, Kentucky state government pays for 97% of the cost of single health insurance coverage. The amount contributed by the state covers the entire cost of single coverage for all but the most expensive level of coverage offered to state employees (rates are higher for smokers).

#### 2010 KEHP Rates

##### *Commonwealth Maximum Choice*

	Total Premium	Employer Contribution	Employee Contribution*
Single	\$575.42	\$575.42	\$0.00
Parent Plus	\$851.46	\$742.60	\$108.86
Couple	\$1,177.68	\$843.02	\$334.66
Family	\$1,341.52	\$943.20	\$398.32
Family Cross Reference**	\$670.76	\$661.10	\$9.66

##### *Commonwealth Optimum PPO*

	Total Premium	Employer Contribution	Employee Contribution*
Single	\$616.28	\$588.78	\$27.50
Parent Plus	\$889.54	\$713.02	\$176.52
Couple	\$1,363.40	\$893.88	\$469.52
Family	\$1,515.36	\$954.20	\$561.16
Family Cross Reference**	\$757.68	\$729.34	\$28.34

##### *Commonwealth Capitol Choice*

	Total Premium	Employer Contribution	Employee Contribution*
Single	\$594.14	\$589.14	\$5.00
Parent Plus	\$896.06	\$752.04	\$144.02
Couple	\$1,347.50	\$903.38	\$444.12
Family	\$1,490.60	\$964.76	\$525.84
Family Cross Reference**	\$745.30	\$732.42	\$12.88

##### *Commonwealth Standard PPO*

	Total Premium	Employer Contribution	Employee Contribution*
Single	\$486.40	\$486.40	\$0.00
Parent Plus	\$749.84	\$741.56	\$8.28
Couple	\$1,127.80	\$845.62	\$282.18
Family	\$1,253.56	\$965.12	\$288.44
Family Cross Reference**	\$626.78	\$626.78	\$0.00

Source: Commonwealth of Kentucky, 2010 Rates, Kentucky Personnel Cabinet

It is common in the private sector to require employees to pay a portion of the premium. The average private sector employee now pays 20% of his/her health premium, compared to only 3% for state employees. With approximately 156,683 active employees and retirees, the

following provides examples of the potential savings that could be generated by requiring state employees to contribute \$25 to \$50 per month toward health coverage:

- \$25 per month employee contribution = \$47 million total annual savings
- \$50 per month employee contribution = \$94 million total annual savings

This approach would not actually cost employees the full amount of their contribution. Because contributions for health insurance are not subject to tax, requiring employees to contribute \$25 to \$50 per month for health insurance would in turn reduce the employees' tax liability by \$300 to \$600 annually, a tax savings of up to \$149 per year for an average state employee.

- **Provide employees with a fixed dollar amount indexed for inflation:** Some local governments in Kentucky provide employees with a specific amount of money that they can use to buy life/health insurance and other fringe benefits. Kentucky could adopt a similar approach and adjust the amount each year based on inflation or availability of funds rather than the cost of the benefit package (which is the current approach). This method would essentially require employees to contribute some additional amount for health coverage, depending on the level of coverage selected. Total savings would depend on the amount of subsidy provided.
- **Incentives for Wellness:** More than half (60%) of the costs in the Kentucky Employees Health Plan result from treatment for a short list of health conditions (such as musculoskeletal, circulatory, digestive and other chronic problems). Kentucky has launched efforts to reduce these costs by promoting wellness and better management of chronic conditions. The state offers a voluntary "informed care management" program where nurses work with participants to lower their health costs. In 2008, more than 95,000 employees with chronic conditions were targeted for this program, and 15% were engaged in the program at some level (up from 10% in 2007), with 4% actively engaged with a nurse (up from 2.7% in 2007).<sup>16</sup>

The Chamber believes Kentucky should promote personal responsibility to improve individuals' health and reduce health costs. A number of states are moving aggressively by offering incentives to employees who participate in wellness activities. The National Governors Association Center for Best Practices has identified several state programs as models:

- **Alabama:** Starting in 2010, Alabama state employees will be required to pay a \$50 per month health insurance premium (an increase from the current \$25 per month). Employees can avoid this increase by participating in a health screening program which checks blood pressure, cholesterol, glucose and body mass index, etc.) If an employee is found at risk, he/she can still avoid the premium increase by participating in wellness and self-management programs. Employees who do not complete health screenings or manage conditions will be required to pay the higher premium.<sup>17</sup>
- **Oklahoma:** By completing a health risk assessment and attending two follow-up evaluations with primary care physicians, Oklahoma state employees can earn up to \$500 a year in cash awards. State agencies fund the awards and decide whether to participate in the program. Participating agencies can choose the level of awards to offer employees: \$100 (bronze level); \$300 (silver level); or \$500 (gold level) for completing the assessment and physician visits. More than 4,000 state employees and half of all state agencies have participated in this program.<sup>18</sup>
- **South Dakota:** State employees who meet exercise goals (exercising five days a week for three consecutive months) can receive \$100 per year in a Health Reward and Wellness Account. Funds in the account can be used in one of two ways: for co-payments, deductibles and coinsurance; or for exercise equipment and gym membership.<sup>19</sup>

- **Arkansas:** Under the Healthy Lifestyle Program, state employees can earn vacation time by participating in health-related activities such as quitting smoking, exercising and eating healthy diets. The maximum time awarded is three days of extra time off, which employees can earn by committing to exercise three days a week, eat five servings of fruits and vegetables five days a week, and not smoke for a year.<sup>20</sup>

The Chamber recognizes the value of wellness activities in reducing health costs and has recently developed a Workplace Wellness Tool Kit to help employers set up effective wellness programs. The Chamber also supported an increase in Kentucky's cigarette tax to discourage smoking in recognition of the fact that smoking-related illnesses cost Kentucky more than \$1.5 billion per year in health costs. The Chamber strongly supports state government adopting one or more of these approaches to encourage public employees to participate in wellness programs.

### **The Bottom Line**

The Chamber believes that public employees make a positive difference in the lives of Kentuckians every day. The spiraling costs of public employee health insurance make it essential that Kentucky find ways to ensure the ongoing sustainability of this important benefit. Rising insurance costs mean less funding will be available for the salaries of state employees, to improve schools, build roads, and pay for fire and police protection. Kentucky needs to act now to develop the long-term strategies needed to counter the threat that benefit costs represent to the basic services that its citizens must have.

### **References**

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  - <sup>3</sup> Ibid
  - <sup>4</sup> Kentucky Public Pension Work Group, State Funding Final Report, October 2008
  - <sup>5</sup> Kentucky Employees Health Plan, Eighth Annual Report, October 2009
  - <sup>6</sup> Average Single Premium per Enrolled Employee For Employer-Based Health Insurance, 2008, and Percent of Private Sector Establishments That Offer Health Insurance to Employees, 2008, Kaiser Family Foundation, statehealthfacts.org
  - <sup>7</sup> Ibid
  - <sup>8</sup> Certification of Actuarial Results, Cavanaugh Macdonald Consulting for the Kentucky Retirement Systems, October 2008
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  - <sup>13</sup> Overview: Kentucky State Government Budgets, Fiscal Years 1986-88 through 2008-10, Taylor-Gray Associates, September 2008
  - <sup>14</sup> Ibid
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  - <sup>16</sup> Kentucky Employees Health Plan, Eighth Annual Report, October 2009
  - <sup>17</sup> State Employee Health Management Initiatives, Center for Best Practices, National Governors Association, July 2009
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  - <sup>20</sup> Ibid