Bad Ideas

A series examining proposals that could move private insurance in the wrong direction

HSAs: Missing the Target

This fact sheet examines the effects that health savings accounts (HSAs) will have on those without health insurance and on the health care system overall. We find that HSAs will do little to help the uninsured gain affordable coverage and will not contain health insurance costs. In fact, over the long run, HSAs will harm those who need health care the most. They represent a radical departure from our current health care system and would exacerbate the racial and ethnic health disparities we see today.

HSAs qualify for special tax breaks—but only if they are coupled with a health insurance plan that has a high deductible (at least $2,100 for family coverage. For more background on HSAs, see "What Is an HSA?" on page 7).

HSAs Won't Reduce the Number of Americans without Health Insurance

HSAs and their companion high-deductible health plans are often touted as affordable health insurance alternatives for the uninsured. As President Bush said in a 2004 speech, "HSAs will make it easier for some people who are now uninsured to purchase health insurance."[1] The facts show, however, that HSAs are not affordable options for the uninsured and are thus unlikely to significantly reduce the overall number of uninsured Americans.

- **The vast majority of uninsured Americans have low incomes:** One-third of the uninsured earn less than $25,000 a year, and another one-third earn between $25,000 and $50,000 a year.[2]
- **Most uninsured Americans would be unable to save large amounts of money to put into HSAs:** Because most low-income people have little disposable income left after paying for housing, food, and other necessities, it is unlikely that they could manage to save enough money in their HSA to even cover the deductible—a minimum of $1,050 for an individual or $2,100 for a family. Some families would need to save as much as $10,500 to pay their deductibles and cost-sharing, or even more if they required services that were not covered by their plans.

- **The tax subsidy that supports HSAs is too small to reach people with low incomes:** Those at the bottom of the income scale who are too poor to pay federal income taxes would receive *no* subsidy. And those with slightly higher incomes who fall in the lowest tax bracket would receive a mere 10 cents for every dollar they put into an HSA. Thus, the HSA tax break offers low-income people too small a subsidy to enable them to sign up for an HSA.

HSAs Are Not an Effective Way to Control Costs

The Administration has praised HSAs for many reasons, but primarily as a way to contain health care costs. In *The Economic Report of the President*, HSAs coupled with high-deductible health plans are touted as an alternative to comprehensive coverage that "dull[s] the incentives for consumers to shop carefully for cost-effective health care." The report continues, "By giving consumers both the incentives and the information needed to become better shoppers for health care, public policy can help control the growth in health care costs and improve the efficiency of the use of health care resources." [3] However, there are several flies in this ointment.

- **HSAs may induce consumers to skip necessary services, leading to higher costs in the long run:** HSAs put consumers in the position of choosing between keeping money in their pockets and paying to see the doctor. Research has repeatedly shown that even modest increases in cost-sharing lead to consumers using fewer preventive and necessary services.[4] Low-income people are even less likely to seek care if they must pay the full bill.[5] They reduce their use of essential drugs, for example, and this leads to serious health problems and to increased use of emergency rooms.[6] When consumers wait until they are very sick to seek treatment, health care costs rise significantly. In fact, a 2005 survey found that, due to the cost, enrollees in high-deductible health plans were significantly more likely to delay or go without health care when they were sick than were enrollees in comprehensive plans. [7]
- **Individual consumers have little ability to reduce provider costs:** HSA proponents further argue that making consumers shop for less expensive care will create competition among health care providers, forcing them to reduce their charges. This theory, however, is flawed. Individual consumers do not have the market clout needed to obtain the lowest prices. It is doubtful that doctors and hospitals will reduce charges beyond the discounted rates insurance companies have already negotiated with them.
- **Individual consumers cannot "comparison shop" for health care:** Shopping for quality, affordable health care is simply not a reasonable option for the vast majority of Americans for a variety of reasons, including lack of knowledge, time, and available information:

- Shopping for health care is not like shopping for a cheap television. Consumers shopping for electronics may be willing to accept some sacrifice in quality for a cheaper price, but no health care consumer wants to accept low-quality care.
- While consumers will check prices at a number of retailers to find the best price before buying, someone having a possible heart attack should not be expected to call around to hospitals looking for the lowest price tag for treatment.
- Consumers lack the specialized knowledge required to choose among health care options. Essential information about health care quality and cost is unavailable to most consumers, so they will not have the information needed to make informed choices.[8] A 2005 survey showed that very few high-deductible plans (including those that can be used with an HSA) provided any information about the cost or quality of doctor or hospital services.[9] Furthermore, making cost information more widely available may not solve the problem: Some economists hold that publicizing the prices that hospitals offer insurers (including those charged under high-deductible plans) may actually cause hospital prices to increase. [10]
- For many consumers, language barriers make shopping for care extremely difficult: About 45 million Americans have limited English proficiency. Most of those with limited English proficiency are Latino and Asian, and these numbers are increasing.[11]

Without the necessary information, consumers will not be able to protect their health while reducing the cost of their health care through "smart shopping."

- **Increasing consumer exposure to health care costs will net little in cost savings**: Even if HSAs succeed in curbing consumer spending on health care, the savings would be trivial compared to total health care spending. Many analysts, including the Congressional Research Service and the Administration itself, have reached this conclusion.[12] People with chronic conditions account for the vast majority of total health care spending, but they have little in the way of flexibility to shop for cheaper care. According to the Tax Policy Center, 95 percent of all medical expenditures from insured households would exceed HSA deductibles.[13] Since there's no incentive for consumers to bargain hunt after they've reached their deductible, there's no reason to think HSAs will have a cost-cutting effect on 95 percent of medical spending. Ironically, the only way for HSAs to have a real effect on cost containment would be to drastically increase the minimum deductible so more households would face the pressure to save money.

HSAs Are Inequitable and Will Harm Many Consumers

While it is doubtful that HSAs can achieve the positive goals of curbing health care costs and reducing the number of uninsured Americans, there are additional "unintended consequences" of HSAs that are cause for concern.

- **Racial and ethnic minorities suffer disproportionately from chronic conditions and are thus less likely to benefit from HSAs:** For example, African Americans and Latinos are twice as likely to suffer from diabetes as whites.[14] Since racial and ethnic minorities are more likely to have acute or chronic conditions and are more likely to have low incomes, they are far less likely to benefit from HSAs and far more likely to be harmed by the high deductibles in the associated health plans.
- **The HSA tax subsidy disproportionately rewards those who least need help:** The tax deduction for contributions to an HSA account amounts to an indirect subsidy from the federal government. This subsidy gives the most to those who need it the least—those with higher incomes—and offers the least to the majority of uninsured people who have lower incomes. A dollar placed in a health savings account saves 35 cents for a person in the 35 percent tax bracket, while it saves just 10 cents for a person in the 10 percent tax bracket.
- **HSAs may induce consumers to skip *necessary* health care services:** As noted previously, HSAs encourage many consumers to delay or forgo treatment, which can be harmful to their health. This is particularly true for people with low incomes, who have less ability to absorb higher up-front costs.
- **Rather than reducing overall costs, HSAs provide employers with a new way to pass cost increases on to workers:** For families, deductibles for plans that can be used with HSAs range from $2,100 to $10,500 in 2006, and there is no guarantee that employers will help fill this hole. In 2006, 37 percent of employers who offered high-deductible plans contributed nothing to their employees' HSAs, leaving workers to meet the high deductibles on their own. And when employers did contribute, their contribution generally fell far short of the plan's deductible. One survey found that, among employers who did contribute, the average contribution was $988 for single coverage and $1,632 for family coverage. The average deductible in an employer-sponsored plan that can be used with an HSA was $2,011 for single coverage and $4,008 for family coverage in 2006. [15] And even after they have met their deductibles, people in high-deductible health plans face other out-of-pocket costs: They may be charged copayments, and they must pay the full cost of any care that is not covered by their health plans. Rather than reducing costs, HSAs and high-deductible health plans simply shift the burden of health care costs from employers to workers.

- **As young and healthy employees switch to HSAs, health insurance will become too costly for older and less healthy employees:** Employees who are not in perfect health cannot afford the high out-of-pocket costs of the high-deductible plans that must be used with HSAs. Given a choice, they would likely remain in traditional plans, while many of their healthier coworkers would switch to HSAs. Thus, less-healthy employees will be grouped together in traditional plans, which will result in increased premiums for those plans. Many employers would then choose to drop traditional plans rather than pay these higher premiums. HSAs, therefore, may actually *increase* the number of Americans without health insurance.

HSAs Are a Radical Threat to Our Current Health Insurance System

HSAs threaten our nation's existing health insurance system. The basic concept that underlies health insurance is the pooling together of many individuals' risks in order to ensure that none are left unprotected from the costs of treating a catastrophic illness. Our current system pools people through their workplace. While not a perfect pooling mechanism, our employer-based system helps protect older and sicker individuals from higher health care costs by pooling them with younger, healthier coworkers.

By design, HSAs are attractive to the young, the healthy, and the wealthy. HSAs therefore increase the likelihood that these same individuals, whose lower health care costs balance out overall health care costs in traditional insurance plans, will enroll in high-deductible plans with HSAs so they can take advantage of the tax benefits. Consequently, older, poorer, and sicker individuals—who either do not make enough to benefit from the tax incentives of HSAs, cannot afford the high out-of-pocket costs necessary to enroll in high-deductible plans, or both—will remain in traditional, low-deductible insurance plans. Therefore, isolating the sickest and poorest in one pool—without the youngest and healthiest to help balance costs—will result in substantial increases in premiums for the population most at risk and least able to pay.

- **Wealthier individuals are more likely than others to enroll in HSAs:** When given a choice between an HSA with a high-deductible health plan and a comprehensive plan, wealthier people are the ones that choose high-deductible plans. For example, Federal Employees Health Benefits Program (FEHBP) enrollees who chose high-deductible health plans in 2005 were about twice as likely to have incomes of $75,000 or more as were those who enrolled in more traditional, comprehensive health plans. [16] As mentioned earlier, wealthier individuals stand to earn at least twice as much in tax breaks from HSAs as people with modest incomes—a family of four with $40,000 in income would get a $470 tax break for depositing $4,000 in an HSA, but a similar family with $120,000 in income would enjoy a $1,240 tax break for putting the same $4,000 into an HSA. And of course, the higher-income family will have a much easier time setting

aside this amount. In fact, HSA marketing materials often stress HSAs' value as a tax shelter (rather than as a vehicle to pay for health care) and show how much people will gain over time through both tax breaks and interest.

- **Healthier individuals are more likely to enroll in the high-deductible plans that can be used with HSAs:** High-deductible plans only pay off if the consumer does not expect to have many medical expenses. Only healthy people are likely to take that risk.
- **As wealthier and healthier individuals move into HSAs, traditional coverage will become more expensive:** As younger and healthier consumers move into high-deductible plans, older and less healthy consumers will be left in traditional plans, driving up the costs of these plans. Research indicates that this rise in costs could be immediate and significant.[17] Either the older and less healthy workers will be stuck with higher costs, or employers will drop their traditional plans—forcing older and sicker workers into less favorable HSA plans, into the individual market, or into the growing ranks of the uninsured.
- **HSAs drain valuable dollars from the health care system:** As wealthier and healthier Americans save money by switching to HSAs, less money will flow into the nation's health care system. HSAs allow healthy people to move their health care dollars into their non-health care budgets. Yet the overall amount of health care services Americans need will not be reduced. Unfortunately, that gaping hole in available dollars needed to support our health care system will have to be filled, and the burden may fall on those who do need, and must pay for, health care (either through their insurance premiums or directly). The bottom line is that there will be less money in the health care system, and that money will have to be recouped through higher overall prices for health care for everyone.

HSAs Create More Problems than They Solve

HSAs do not solve the problems they were supposedly created to solve—the rising cost of health insurance and the growing number of uninsured. Instead, they place a strain on the consumers who can least afford, and most need, health insurance, while the rich and healthy benefit. Under current law (without considering the impact of additional changes now being considered that would make premiums for high-deductible plans tax-deductible), HSAs will cost our nation $17.1 billion in lost income taxes from the five-year period from 2007-2011.[18] HSAs represent a radical change in our health care system that will drain money from our nation's budget without solving any of the very serious problems facing our current system.

What Is an HSA?

Health Saving Accounts (HSAs) were established as part of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (MMA). HSAs offer tax benefits for people who purchase insurance policies with high deductibles. To qualify for the HSA tax break, the policy must have a deductible of at least $1,050 (for an individual) or $2,100 (for a family) in 2006. Deductibles and other out-of-pocket expenses may run much higher: the maximum out-of-pocket costs for deductibles and copayments for a family is $10,500 in 2006, but in addition to this amount, the family may incur other medical expenses that are not covered by the plan at all.

An HSA is a tax-preferred savings account. Deposits into the HSA may be deducted from income for federal income taxes. A maximum of $2,700 (for an individual) or $5,450 (for a family) can be deducted in 2006. The tax-deductible contributions may be placed into an HSA by an individual, an employer, or both.

Withdrawals from health savings accounts that are used to pay for out-of-pocket health care costs are tax-free, while withdrawals for non-medical uses are subject to income tax and a 10 percent penalty for people under the age of 65. Money that is not used can be rolled over from one year to the next.

Individuals over the age of 65 may withdraw money from their accounts—for any reason—without facing the penalty. Money in the accounts can be invested in stocks and bonds without incurring tax on the earnings.

HSAs became available on January 1, 2004, and the high-deductible plans that can be used with HSAs have continued to gain popularity with employers with each passing month. Recent surveys show that 2 to 3 million people were in HSA-qualified health plans by January 2006 but that many of these enrollees had not actually opened HSAs.*

* Surveys summarized in U.S. Government Accountability Office, *Consumer Directed Health Plans: Small but Growing Enrollment Fueled by Rising Cost of Health Care Coverage*, GAO 06-514 (Washington: General Accounting Office, April 2006).

Endnotes

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[2] *Income, Poverty and Health Insurance Coverage in the United States: 2005* (Washington: U.S. Census Bureau, 2006).

[3] *2006 Economic Report of the President* (Washington: Government Printing Office, 2006).

[4] Key findings of the RAND Health Insurance Experiment Study (HIE) are described in Geri Dallek, *A Guide to Cost-Sharing and Low-Income People* (Washington: Families USA, October 1997).

[5] Karen Davis, *Will Consumer-Directed Health Care Improve System Performance?* (Washington: Commonwealth Fund, August 2004).

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[8] Gail Shearer, Testimony before the Joint Economic Committee (February 25, 2004).

[9] Fronstin and Collins, op. cit., and Sara Collins et al., *Squeezed: Why Rising Exposure to Health Care Costs Threatens the Health and Financial Well-Being of American Families* (New York: Commonwealth Fund, September 2006).

[10] Ha T. Tu, Testimony before the Subcommittee on Health of the House Committee on Ways and Means (July 18, 2006).

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[12] Edwin Park, *Health Savings Accounts Unlikely to Significantly Reduce Health Care Spending* (Washington: Center on Budget and Policy Priorities, June 12, 2006) reviews the literature on this point.

[13] Linda Blumberg and Leonard Burman, *Most Households' Medical Expenses Exceed HSA Deductibles* (Washington: Tax Policy Center, August 2004).

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[16] U.S. Government Accountability Office, *Federal Employees Health Benefit Program: First Year Experience with High-Deductible Health Plans and Health Savings Accounts*, GAO-06-721 (Washington: Government Accountability Office, January 31, 2006).

[17] Len Nichols, *Tax-Preferred Medical Savings Accounts and Catastrophic Health Insurance Plans* (Washington: Urban Institute, April 1996).

[18] Office of Management and Budget, *Analytical Perspectives: Fiscal Year 2007* (Washington: Office of Management and Budget, 2006).

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