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. (For background on HSAs, see "What Is an HSA?" on page 6.)

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

HSAs 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 per 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 $1,000 (or much more, in some cases) to put into an HSA.
- **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 are said to have "the potential to increase the efficiency and therefore the cost-effectiveness of health care markets."[3] Proponents of HSAs maintain that, when consumers must spend money out of their own pockets on health care, they will avoid "unnecessary" health services and will shop for health care bargains. 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] When consumers wait until they are very sick to seek treatment, health care costs rise significantly.
- **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. A health care consumer shopping for services would be treated as if he or she were uninsured. And the uninsured, who lack access to the negotiated discounts of a provider network, can be charged more than twice as much as the insured for the same care.[6]
- **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. Electronics consumers 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.[7]

- 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.[8]

  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. 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.[9] 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.[10] Since racial and ethnic minorities are more likely to have acute or chronic conditions and are more likely to be low-income, they are far less likely to benefit from HSA plans and far more likely to be harmed by high deductibles.
- **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 above, 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 reduce overall costs, HSAs provide employers with a new way to pass cost increases on to workers:** For families, HSA deductibles range from $2,000 to $10,000, and there is no guarantee that employers will help fill this hole. Mercer Human Resource Consulting reports that, by 2006, nearly two-thirds of employers will contribute less than $500 to employees' HSAs. Of those employers, 39 percent will contribute nothing, leaving workers to meet high deductibles on their own.[11] Rather than reducing costs, the burden will simply be shifted 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 HSAs. Given a choice, they would be likely to 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 rates for those plans. Many employers would then choose to drop traditional plans rather than pay these higher rates. 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 HSAs, or both—will remain in traditional, low-deductible insurance plans. Therefore, isolating the sickest and poorest in one pool—without the youngest, healthiest, and wealthiest 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 to enroll in HSAs than others:** Fewer than 20 percent of Americans earn $50,000 or more,[12] while more than two-thirds of HSA purchasers had incomes above $50,000 per year.[13]

- **Healthier individuals are more likely to enroll in 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 HSA 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.[14] 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 $7 billion in lost income taxes over the next five years.[15] 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 $1,000 (for an individual) or $2,000 (for a family), but they may run as high as $10,200.

An HSA is a tax-preferred savings account. Deposits into the HSA may be deducted from income for federal income taxes. A maximum of $2,600 (for an individual) or $5,150 (for a family) can be deducted in one year. 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 they have continued to gain popularity with employers with each passing month. A survey by Mercer Human Resource Consulting found that 73 percent of employers said they were at least somewhat likely to offer HSAs by 2006.*

* *Survey on Health Savings Accounts* (Washington: Mercer Human Resource Consulting, April 2004).

Endnotes

[1] George W. Bush, *President Bush Discusses Quality, Affordable Health Care* (Washington: White House Press Release, January 28, 2004), available online at http://www.whitehouse.gov/news/releases/2004/01/print/20040128-2.html, accessed on October 17, 2004.

[2] *Health Insurance Coverage in the United States* (Washington: U.S. Census Bureau, 2002).

[3] *2004 Economic Report of the President* (Washington: Government Printing Office, 2004).

[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: The Commonwealth Fund, August 2004).

[6] *Why the Working Poor Pay More* (Washington: SEIU, March 2003).

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

[8] *2004 U.S. Census,* accessed online at http://www.census.gov/population/cen2000/phc-t20/tab01.pdf on October 28, 2004.

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

[10] *Health, United States, 2003* (Washington: National Center for Health Statistics, 2003).

[11] *Survey on Health Savings Accounts* (Washington: Mercer Human Resource Consulting, April 2004).

[12] *2004 U.S. Census,* op. cit.

[13] Edwin Park and Robert Greenstein, *Data on Individual Market Enrollment Fail to Dispel Concerns* (Washington: Center on Budget and Policy Priorities, September 2004).

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

[15] Office of Management and Budget, *Analytical Perspectives: Fiscal Year 2005* (Washington: Office of Management and Budget, 2005), p. 292.

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