

HSAs: Why High-Deductible Plans Are Not the Solution

This fact sheet examines the effects that health savings accounts (HSAs) will have on those without health insurance and 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: Not a Solution for the Uninsured

Tax-preferred HSAs are often touted as affordable plans 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 health care options for the uninsured. While the high-deductible insurance plans associated with HSAs will have lower premiums than conventional plans, these deductibles would force the currently uninsured to pay more than they can afford for health coverage. Moreover, since the tax breaks associated with such plans are skewed toward people with higher incomes, lower-income uninsured people would not receive enough of a subsidy to make insurance affordable to them.

- 1) **HSA tax breaks will not make health insurance affordable for uninsured Americans.** The lower the tax bracket a person is in, the less he or she benefits from tax deductions. 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 A significant proportion of uninsured Americans, including many uninsured racial and ethnic minorities, earn too little to pay any income taxes, so they would receive no benefit from this tax shelter. 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. Lower-income Americans will not be able to afford health insurance, even high-deductible plans, with this meager subsidy.

- 2) **Uninsured people will not have the ability to save money in their health savings accounts.** The uninsured, who generally have low incomes, do not have the necessary disposable income that would allow them to save large amounts of money in their HSAs. It is doubtful that low-income people—after paying for housing, food, and other necessities—would be able to save \$1,000 dollars (or much more) in an account in order to pay for out-of-pocket medical costs. Deductibles for HSAs range from \$1,000 all the way up to \$10,000. Without the ability to save money to pay for health care until a high deductible is reached and coverage begins, lower-income people are unlikely to choose HSAs.
- 3) **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 will not make health insurance affordable for people who are currently uninsured. The tax benefits they would receive, if any, would be far too little to offset the high out-of-pocket costs that accompany high-deductible plans. Additionally, HSAs will make health insurance unaffordable for some people who are currently insured, forcing them to drop coverage and join the ranks of the uninsured.

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 purchasing insurance policies with high deductibles of at least \$1,000 for an individual and \$2,000 for a family. However, the deductibles in an HSA plan may run as high as \$10,200.

An HSA is a tax-preferred savings account that allows people to deduct deposits for federal income tax calculation. Only deposits up to \$2,600 for an individual or \$5,150 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. Money not used can be rolled over from year to year. Individuals over the age of 65 may withdraw money from their accounts for any reason without being taxed. 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).

HSAs: 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. In theory, this will create competition among health care providers, forcing them to reduce their charges. This theory, however, is flawed. While consumers might end up buying less health care, it is doubtful that doctors and hospitals will reduce charges beyond the discounted rates insurance companies have already negotiated with them. In addition, even if consumers spending their HSA dollars can successfully shop for health care bargains (or forgo care), the amount saved would not be enough to affect system-wide health care spending.

In reality, HSAs won't help contain rising health care costs. 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. Instead, HSAs will encourage consumers to skip medical services, which could lead to catastrophic costs down the line. Instead of reducing overall costs, HSAs simply shift risk and costs from employers to workers.

- 1) **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.⁴ Language barriers also present a barrier to shopping for care: About 45 million Americans have limited English proficiency. Most of those with limited English proficiency are Latino and Asian, and these numbers are increasing.⁵ Without the necessary information, consumers will not be able to protect their health while reducing the cost of their health care through “smart shopping.”
- 2) **Shopping for health care is not like shopping for a cheap television.** Electronics consumers may be willing to sacrifice quality for a cheaper price, but quality care is a necessity for every health care consumer.
- 3) **Individual consumers do not have the market clout to obtain the lowest prices.** A health care consumer shopping for services would be treated as if he or she were uninsured. Without the negotiated discounts of a provider network, the uninsured can be charged more than twice as much as the insured for the same care.⁶
- 4) **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 or 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.⁷ Low-income people are even less likely to seek care if they must pay the full bill.⁸ When consumers wait until they are very sick to seek treatment, health care costs rise significantly.

- 5) **Rather than reduce costs, HSAs provide employers with a new way to pass additional costs 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.¹⁰ Rather than reducing costs, the burden will simply be shifted from employers to workers.
- 6) **The savings that could result from consumer price sensitivity would be trivial compared to total health care spending.** According to the Tax Policy Center, 95 percent of all medical expenditures from insured households would exceed HSA deductibles.¹⁰ People with chronic conditions account for the vast majority of total health care spending. Consumers with chronic conditions have little in the way of flexibility to shop for cheaper care. Additionally, 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.

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.¹¹ 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.

Given all of the impediments to consumers shopping for health care, it is unlikely that HSAs will reduce total health care costs. Even if these impediments were miraculously removed, the scope of the possible cost containment would be miniscule relative to the constantly increasing total health care spending in America.

HSAs: A Radical Threat to Our Current Health Insurance System

HSAs threaten our nation's existing health insurance system. The basic concept of insurance is to pool together the risks of many individuals 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. There-

fore, 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.

- 1) **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
- 2) **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.
- 3) **As HSAs become more commonplace, 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.
- 5) **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.

HSAs: More a Problem than a Solution

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 health care system.

Endnotes

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- ⁵ 2004 U.S. Census (accessed online at <http://www.census.gov/population/cen2000/phc-t20/tab01.pdf> on October 28, 2004)
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