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EXPANSION IN HSA TAX BREAKS IS LARGER – AND MORE PROBLEMATIC -- THAN PREVIOUSLY UNDERSTOOD

By Jason Furman

Summary

In conjunction with the State of the Union Address, the President proposed an expansion of tax breaks both for Health Savings Accounts (HSAs) and for premiums for the high-deductible insurance policies that are purchased in conjunction with HSAs. The President is proposing a large increase in the amount that can be contributed to a HSA on a tax-advantaged basis. In addition, the President is proposing not only to give individuals a tax deduction but also to provide a tax credit both for contributions made to HSAs and for amounts spent on insurance premiums for high-deductible insurance policies purchased in the individual market by people using HSAs. These proposals would cost \$132 billion over ten years and account for the bulk of the President's proposed \$156 billion in proposed HSA-related tax cuts.¹ The proposals would cost substantially more in subsequent decades.

These proposals go well beyond anything the President has proposed before. In fact, in important respects, the President's proposal is significantly more radical than the proposal that many media accounts have described in recent weeks as the template for his reforms: a book by economists John Cogan (who is close to the Bush administration), Glenn Hubbard (who was President Bush's first Chairman of the Council of Economic Advisers) and law professor Daniel Kessler. Although these authors, all of whom are conservatives, favor more individual-market insurance, they deliberately retained at least some tax advantage for employer-based coverage in their plan to ensure that "any shift toward individual insurance [and away from employer-based coverage] would therefore be limited and gradual."² Yet the White House plan has no such safeguard. Instead, by proposing a new tax credit on top of HSA-related tax deductions, the Administration would eliminate any remaining tax incentive for employer-based coverage. As explained below, the

¹ The other \$24 billion reflects the cost of an accompanying Administration proposal for a refundable tax credit for low- and moderate-income families to purchase HSA-eligible, high-deductible health insurance plans in the individual market. For a discussion of an earlier version of this proposal, see Edwin Park, "Administration's Proposed Tax Credit for the Purchase of Health Insurance Could Weaken Employer-Based Health Insurance," Center on Budget and Policy Priorities, revised April 6, 2004.

² John Cogan, Glenn Hubbard, and Daniel Kessler, "Making Markets Work: Five Steps to a Better Healthcare System," *Health Affairs* 24(6), November/December 2005.

Administration's proposals would likely have significant adverse effects on the employer-based health system.

The President's new HSA proposals suffer from four types of serious problems:

- *They would weaken the existing health insurance system.* The proposals would fragment the pooling of risk that helps the health system to function. Over time, the proposals would shift people into the costlier individual health insurance market and isolate less healthy people in higher-cost comprehensive insurance plans, thereby driving up the costs of those plans. The proposals also could result in an increase in the ranks of the uninsured, by leading to an erosion of employer-based coverage. For reasons discussed below, the President's proposal also would be likely to reduce the amounts saved in retirement savings plans, as people shifted funds from IRAs and 401(k)s to HSAs.
- *They have little potential to improve the health system.* The President's philosophy is that "consumer-driven health care" will lead people to become wiser health consumers. This approach has limited potential for cost containment, however, because most of the costs in the health system are for expensive procedures or treatments (often related to major illnesses or end-of-life costs) whose costs exceed the deductibles under high-deductible policies and consequently would still be paid by insurance companies. For example, the top 10 percent of health care users account for about 70 percent of total health expenditures in the United States, while the bottom half account for only three percent of total expenditures.³ More fundamentally, the President has no plan to remedy two major problems that have to be addressed for consumer-directed health care to work: the lack of data that would help consumers understand health care prices and quality, and an adequate pooling mechanism to allow less healthy people to purchase insurance they can afford.
- *They provide the largest assistance for the most fortunate.* The proposals would provide large tax breaks for the most affluent people while providing little for moderate-income families who have the hardest time paying their medical bills. In particular, by substantially increasing the amounts that can be placed in HSAs and establishing new tax credits on top, the proposals would make HSAs a highly lucrative tax shelter for high-income families, enabling them to amass hundreds of thousands of dollars tax free.
- *They would increase the deficit, especially in future decades when the nation already will be under fiscal strain.* The new HSA-related proposals would cost \$156 billion over ten years. A good part of the cost would be masked by the five- or ten-year cost estimates. It would show up only in subsequent decades, when the costs of these proposals would mushroom.

This paper analyzes the new aspects of the tax breaks proposed by the President in his State of the Union address and the further details provided in the Treasury Department's *General Explanations of the Administration's Fiscal Year 2007 Revenue Proposals* (also known as the "Blue Book") released in

³ Linda J. Blumberg, Lisa Clemans-Cope, and Fredric Blavin, "Lowering Financial Burdens and Increasing Health Insurance Coverage for Those with High Medical Costs," Urban Institute, December 2005.

conjunction with the new budget proposal. A Center analysis issued January 31 provides a more comprehensive discussion of various other issues related to these proposals.⁴

The President's New Tax Cuts Would Provide Larger Subsidies for Higher-Income Families

In his State of the Union address, President Bush said the government has the responsibility to “help people afford the insurance coverage they need.”⁵ In conjunction with the State of the Union address, the White House released a fact sheet on January 31 with more details about the President's proposals.⁶ Many of the President's tax proposals build on the HSAs that were established under the 2003 Medicare prescription drug legislation. Under that law, individuals who enroll in high-deductible health plans (in 2006, plans with deductibles of at least \$1,050 for individuals or \$2,100 for families) can contribute to a HSA. Contributions to HSAs are tax deductible, earnings on the HSA accounts accumulate tax free, and withdrawals from the accounts for qualified medical expenses also are tax free. Both employees and employers may contribute to HSAs.

The Administration's new proposals, however, go substantially beyond current-law HSAs and well beyond the President's own previous proposals. The President is proposing the following new tax breaks:

- *Expanded contributions limits for HSAs.* Under current law, total HSA contributions are limited to the lower of the level of the deductible on your insurance policy or a fixed limit that is set at \$2,700 for individuals and \$5,450 for families in 2006. The President proposes to increase these limits to the maximum amount of out-of-pocket expenses allowed under an individual's high-deductible plan. Under current law, in 2006, qualified high-deductible insurance plans can set the cap on out-of-pocket expenses for health care services provided through the plan's “network” at any level up to \$5,250 for individuals and \$10,500 for families. This means the President is proposing to allow tax-deductible contributions to HSAs of as much as \$5,250 a year for individuals and \$10,500 for couples or families.
- *Expanded tax benefits for HSA contributions.* Under current law, contributions by individuals to HSAs are tax deductible. The President's proposal would add, on top of this deduction, an additional 15.3 percent income tax credit, which is intended to offset payroll taxes. Not only would HSA users get a deduction for the amount they contributed to a HSA each year, but they also would get an income tax credit equal to 15.3 percent of the amount of those contributions.
- *Expanded tax benefits for the purchase of insurance in the individual market.* The President proposes to provide tax breaks for the cost of health insurance premiums for qualified high-deductible plans purchased in the individual market in conjunction with a HSA. The cost of these premiums, as well, would be *both* tax deductible and eligible for a 15.3 percent tax credit. (Under current law, non-self-employed individuals can deduct the cost of their health premiums only to the extent

⁴ Edwin Park and Jason Furman, “President's Health Care Tax Cut Proposals Are Likely to Weaken Employer-based Health Insurance, Primarily Benefit High-income People, and Worsen Deficits,” Center on Budget and Policy Priorities, January 31, 2006.

⁵ President Bush, “State of the Union Address,” January 31, 2006.

⁶ White House, “State of the Union: Affordable and Accessible Health Care,” January 31, 2006.

Table 1. The Regressive Tax Benefits of the New HSA Proposals

	Family Making \$15,000	Family Making \$40,000	Family Making \$180,000	Family Making \$180,000
Contribution to HSA	\$1,000	\$1,000	\$1,000	\$10,500
Tax Bracket	0%	15%	28%	28%
Value of Deduction	\$0	\$150	\$280	\$2,940
Value of Tax Credit	\$153	\$153	\$153	\$1,607
Total Tax Subsidy	\$153	\$303	\$433	\$4,547
<i>Memo: Tax Cut Relative to Current Law</i>	\$153	\$153	\$153	\$3,316**

*The estimate assumes their current deductible is \$4,396 – 8 percent higher than the average deductible in HSA-qualified plans in 2005.

that their total out-of-pocket health expenditures exceed 7.5 percent of their adjusted gross income.)

Table 1 illustrates how the HSA proposals would impact typical families. A family making \$15,000 (and thus in the 0 percent tax bracket) would get *no value* from the new tax deduction. If the family contributed \$1,000 to a HSA (which a family at that income level probably could not afford to do), it could get \$153 from the new credit. A family that makes \$40,000 (and thus is in the 15 percent tax bracket) and contributes the same \$1,000 to a HSA would get a tax deduction worth \$150 plus a tax credit worth \$153, for a total government subsidy of \$303. By comparison, if a married couple family that made \$180,000 (and was in the 28 percent tax bracket) contributed the same \$1,000, it would get \$280 from the deduction plus \$153 from the credit for a total of \$433. Thus, the subsidy for a \$1,000 HSA contribution would increase with income.⁷

Furthermore, families with higher incomes generally would be able to afford to contribute more to the HSA accounts. If the hypothetical family at the \$180,000 income level contributed the maximum \$10,500 that would be allowed under the President’s proposal, it would get a \$4,547 tax subsidy. *This is \$3,316 higher than the subsidy the family would get under the current-law tax deduction for HSAs.* In contrast, the hypothetical moderate-income families would get only \$153 more than under current law. That is partly because such families would be far less likely to be able to take advantage of the much higher HSA contribution limits; it is extremely unlikely that many moderate-income families could set aside \$10,500 annually. The higher HSA contribution limit that the President is proposing consequently would provide tax benefits heavily skewed to people at high income levels.

⁷ The example assumes that earnings are split fairly evenly between the two spouses.

The tax subsidies for the cost of premiums for high-deductible insurance policies purchased in the individual market in conjunction with HSAs would function in a similar way: the largest subsidies would go to the families with the highest incomes.

Higher Contribution Limits Would Make HSAs a Lucrative Tax Shelter for High-Income Families' Savings

With the increased contribution limits, HSAs would offer high-income families a generous tax shelter for savings. HSAs would offer several major tax-sheltering benefits, relative to other savings options that are available to people with substantial assets:

- First, HSA contributions are tax deductible, amounts earned on the accounts (which can be invested in stocks, bonds, real estate, or other investments) accumulate tax free, and withdrawals also are tax free as long as they were used for medical expenses.⁸ No other savings vehicle in the U.S. tax code offers the potential for both tax-free contributions and tax-free withdrawals.
- Second, under the President's proposals, HSA contributions would qualify for a 15.3 percent tax credit, a substantial advantage as compared to contributions to 401(k)s or IRAs, for which no such tax credit is provided.
- Third, unlike IRAs, HSAs have *no income limits*. The exceedingly generous HSA tax breaks thus are available to very high-income families.

Table 2 illustrates these benefits for a hypothetical family in the 25 percent tax bracket. The table shows four scenarios under which this family puts away \$10,500. If the family places \$10,500 of its earning in a regular, non-tax favored savings or investment account, the family saves \$6,269 after taxes. If the family directs the \$10,500 to a 401(k), it saves \$8,894, as the earnings placed in the 401(k) plan are exempt from income tax but are subject to the payroll tax. Under the President's proposal, if the \$10,500 is placed in a HSA, this family would retain all \$10,500 free of taxes.⁹ As a result, the HSA would provide even larger tax advantages than a 401(k), especially for affluent families that could afford to make large HSA contributions. Both the amounts deposited in HSAs and the deposits in 401(k)s would accumulate tax free, but withdrawals from the 401(k) would be taxable as ordinary income while withdrawals from the HSA would be tax free, to the extent that the withdrawals did not exceed the family's out-of-pocket medical expenses. (Withdrawals above that level would be taxed as ordinary income plus a 15 percent penalty to recapture the tax credit.) Since a large portion of retirement income goes for out-of-pocket medical costs — including Medicare premiums, deductibles, and co-payments as well as costs for long-term care — a large share of the HSA withdrawals would entirely escape tax.

⁸ Withdrawals after age 65 for non-medical expenses or in the event of disability or death would be subject to a 15 percent penalty tax intended to recapture the tax credit. Withdrawals for non-medical expenses before age 65 would be subject to tax and a 30 percent early withdrawal penalty. Under current law, HSAs, like 401(k)s, have a 10 percent penalty for withdrawals before age 65 and no penalty for withdrawals after age 65.

⁹ Technically, the individual would pay payroll taxes but have their income taxes reduced by an equivalent amount.

Table 2. Tax Implications of Alternative Savings Options

	HSA (withdrawal for medical expenses)	HSA (withdrawal for non- medical expenses)	401(k)	Non Tax- favored
Pre-tax Income Saved	\$10,500	\$10,500	\$10,500	\$10,500
- Tax Payment	-\$1,607	-\$1,607	-\$1,607	-\$4,232
+ Tax Credit	+\$1,607	+\$1,607	--	--
= Total Saved	\$10,500	\$10,500	\$8,894	\$6,269
Pre-tax Value in 2036	\$25,486	\$25,486	\$21,587	\$10,431
Tax on Withdrawal	--	-\$9,239	-\$5,397	--
Total Account in 2036	\$25,486	\$16,247	\$16,190	\$10,431

Notes: This example assumes the person earns a real rate of return of 3 percent annually and is in the 25 percent tax bracket for the entire period. All numbers are adjusted for inflation. The amounts saved are expressed in after-tax dollars.

Altogether, invested conservatively, a single annual HSA contribution of \$10,500 could grow to more than \$25,000 over 30 years. The value of a comparable contribution to a 401(k) – after taxes – would only be \$16,000. An affluent individual who could set aside this amount thus would have *50 percent more money as a result of having saved through a HSA*. Even if the individual only used the HSA for retirement savings, with no intention of using any of it for health costs, he or she would still come out the same or slightly better than saving through a 401(k).

This has several implications. Very high-income people who already are depositing the maximum \$15,000 allowed every year into a 401(k) (or are depositing \$20,000 a year if they are age 50 or over) could place another \$10,500 on top of this in a HSA each year and build up very large tax-sheltered accounts. Other affluent people who cannot save \$15,000 or \$20,000 in a 401(k) and also put away thousands in a HSA could simply shift thousands of dollars each year of what are now 401(k) contributions into a HSA instead to take advantage of the lucrative tax-sheltering opportunities HSAs would offer. Finally, even families with more moderate incomes could find it lucrative to shift some or all of their retirement savings into HSAs. If they withdrew this money early to pay for medical expenses, however, they could be left with little for retirement.

All these types of activity by affluent households would significantly increase budget deficits, especially in years after the normal five-year or ten-year budget “windows.” The deficit effects are discussed below.

Note that Table 2 illustrates only the savings from a single year’s contribution to a HSA at the maximum amount that would be allowed. Steady contributions over a number of years could generate accounts worth hundreds of thousands of dollars and thereby generate far larger tax savings.

These very large new tax breaks for savings would effectively be unrelated to health care. The ostensible motivation of the President's reform proposal is to "level the playing field" between employer-based health insurance and out-of-pocket health care spending by people who purchase high-deductible plans in the individual insurance market. But that could be accomplished simply by making all such expenses tax deductible, without establishing costly savings accounts that can be heavily exploited as tax shelters.¹⁰ (It should be noted that providing a deduction for all out-of-pocket costs incurred by people in the individual health insurance market still would likely induce numerous employers to drop coverage, and as a result, significant numbers of less-healthy individuals might lose employer coverage and be unable to find coverage in the individual market that they could afford.)

Furthermore, the Administration's proposal is designed in a way that would exacerbate the potential for HSAs to be abused as tax shelters, by providing incentives for people to engage in arbitrage to exploit the HSA tax breaks more fully. Individuals would be allowed to borrow money, deduct the interest, and invest the borrowed funds in HSAs. They then would be allowed to take a tax deduction for the HSA contributions made with these borrowed funds and to invest the funds however they wanted, with the investment earnings being tax free. For many people, this could result in an effective *negative* tax rate on capital.¹¹ In this manner, the proposal opens the door to legal tax abuse.

Finally, raising the contribution limits for HSAs is unlikely to stimulate much, if any, additional saving. The higher contribution limits would primarily affect high-income families. These are precisely the people who are most likely to shift existing savings into HSAs to take advantage of the unprecedented tax breaks they offer, rather than to save more.¹²

The President's Proposal Would Undermine Employer-provided Health Insurance and Pensions

As just noted, the President's proposal would provide an unprecedented incentive to save through HSAs rather than 401(k)s or IRAs. This would give small-business owners more of an incentive to save on their own rather than to offer employer pension plans. It also would provide owners an incentive to shift their firms to high-deductible health coverage or to drop employer health coverage altogether.

¹⁰ Even conservative economists who favor "tax neutrality" and a "level playing field" should be troubled by the President's proposal, which actually distorts the tax system *in favor* of paying health bills out-of-pocket and against health insurance. Specifically, under the President's proposal, health insurance premiums would be tax deductible but money set aside for health expenses would *both* be tax deductible and allowed to accumulate tax-free in HSAs. As a result, it would be cheaper to set aside money for future out-of-pocket expenses than for future health insurance premiums.

¹¹ Note, economists who support consumption taxes believe all taxes on investment income should be eliminated. But they would never propose eliminating taxes on investments while still allowing individuals to deduct the interest on their borrowing.

¹² For more general findings along these lines, see Eric Engen and William Gale, "The Effects of 401(k) Plans on Household Wealth: Differences Across Earnings Groups," National Bureau of Economic Research Working Paper No. 8032, December 2000.

Currently, a high-income small-business owner is not eligible to contribute to a Roth IRA if his or her family's income exceeds \$160,000. The owner thus has an incentive to provide a 401(k) through the business so he or she can have access to a tax-favored retirement savings account. HSAs would give this employer the option of dropping the 401(k) and shifting retirement saving to a HSA instead, which would be more lucrative.

As part of this process, the employer also could shift to a high-deductible health insurance plan for the firm. Or, since the President's proposals would provide both a tax deduction and a 15.3 percent tax credit for the purchase of high-deductible insurance in the individual market, the small-business owner could drop employer-sponsored health insurance altogether, in light of the fact that the tax advantages of employer-based coverage would no longer be greater than those of insurance in the individual market. Dropping coverage also might increase the employer's bottom line, depending on whether the employer retained a portion of the savings from not offering health coverage or passed all of the savings through to employees.

The President's Proposal Could Increase the Ranks of the Uninsured and Would Reduce the Quality of Health Insurance Coverage

In 2004, M.I.T. economist Jonathan Gruber, one of the nation's leading health economists, estimated that providing a tax deduction for the premium costs of high-deductible health insurance purchased in the individual market in conjunction with a HSA would cause 1.1 million currently uninsured people to *gain* insurance (generally healthier and more affluent people who stand to benefit the least from insurance), but lead another 1.4 million people to *lose* employer-provided coverage and become uninsured (many of them sicker or lower-income families who would have benefited the most from insurance). Gruber estimated that the net effect of such a proposal, which was included in the Administration's budget last year, would be to add 350,000 people to the ranks of the uninsured.¹³

Estimates of the effects of the President's new proposal are not yet available. Because the President's new proposal also includes a tax credit equal to 15.3 percent of the cost of premiums and HSA contributions, the proposal is likely to increase both the number of newly insured people and the number of people losing insurance because their employer no longer offers it. Since the large increases in the HSA contribution limits and the new HSA tax credit would provide a strong incentive for employers to drop coverage, it is likely the net effect of the proposal would be to increase the ranks of the uninsured by more than last year's more limited proposal would have done.

At best, the Administration's HSA proposals would have little effect on the number of uninsured people. At worst, they would significantly increase the number of uninsured due to employer dropping. Either way, the proposals would fragment the employer-provided group market, casting people into the largely unregulated individual market, which suffers from higher administrative costs and serious problems of adverse selection (i.e., 'cherry-picking' by insurance companies of healthier people, while sicker people are priced out of the market).

¹³ See Edwin Park and Robert Greenstein, "Proposal for New HSA Tax Deduction Found Likely to Increase the Ranks of the Uninsured," Center on Budget and Policy Priorities, May 10, 2004.

The President's Proposal Does Not Include Safeguards Built Into Other Consumer-Driven Care Proposals

In a recent book, *Healthy, Wealthy, and Wise*, conservative economists John Cogan and Glenn Hubbard and law professor Daniel Kessler present a proposal that includes new tax breaks to encourage people to shift to high-deductible plans and to purchase more insurance in the individual market. While the Cogan, Hubbard, and Kessler proposal is problematic and likely would induce some employers to drop coverage,¹⁴ it does include a safeguard that the authors argue would reduce the risk that their proposal would trigger a rapid unraveling of employer-based coverage.

Cogan and his colleagues note that under current law, employer contributions to health insurance are excluded from both payroll taxes and individual income taxes. They propose to allow families to deduct premiums and other medical expenses in the individual market from income taxes but not from payroll taxes. They explain:

“Although deductibility would mitigate the bias against individual insurance (because both employer-sponsored and individual insurance could be acquired with pretax dollars), it [their proposal] still would retain major incentives for the purchase of insurance and for the purchase of employer-sponsored insurance. Because the tax change would allow the deduction of the cost of individual insurance from the income tax base *but not from the payroll tax base*, the proposed policy would retain a tax incentive for the purchase of employer-sponsored insurance. Spending on insurance purchased through an employer would, as under current law, still be excludable from both the income and the payroll tax bases. For this reason, deductibility would be unlikely to increase the number of uninsured people by inducing employers to stop offering insurance to their employees”¹⁵ (emphasis added).

Later in their paper, Cogan *et. al.* note that because their proposal retains a tax advantage for employer-provided insurance, “any shift toward individual insurance would therefore be limited and gradual.”

In contrast, the White House removes the safeguard that Cogan, Hubbard, and Kessler deliberately retain, by providing a 15.3 percent tax credit both for HSA contributions and for the premium costs of plans purchased in the individual market in conjunction with HSAs. The White House plan thereby eliminates all tax advantages for employer-provided insurance. As a result, it would be expected to lead to substantially more employer dropping than the plan developed by Cogan *et. al.*

The core problem is that the President's proposal eliminates the tax incentives underpinning the employment-based system of pooling healthier and sicker people together, without replacing it with another system that pools risk.

¹⁴ For more discussion, see Edwin Park and Jason Furman, “President's Health Care Tax Cut Proposals Are Likely to Weaken Employer-based Health Insurance, Primarily Benefit High-income People, and Worsen Deficits,” Center on Budget and Policy Priorities, January 31, 2006.

¹⁵ Cogan *et. al.*, *op cit.*

The President Does Not Provide Any of the Necessary Ingredients Required by Consumer-Driven Health Care

The potential upsides of the President's proposals for more "consumer-driven health care" are limited. High-deductible policies have only a modest ability to control health care costs, because the top ten percent of health care users account for about 70 percent of total health expenditures in the United States and those expenditures are generally above the deductible amounts and thus continue to be covered by insurance. By contrast, the bottom half of health care users — the group that would be most attracted to HSAs — account for only three percent of total health care expenditures.¹⁶

Moreover, for consumer-driven health care to have any potential, it requires two critical inputs. First, it requires consumers to have access to easily digestible comparative information on the quality and costs of different doctors, hospitals, and medical procedures. As Robert Reischauer, the President of the Urban Institute and former Congressional Budget Office director (and a widely respected health care expert), has stated, "We are, as I said, in the process of developing this information, but we are, I think, many years away from having the kind of quality and cost information that would be necessary to have the average consumer at all comfortable with the decisions that he or she were making."¹⁷

The White House does not appear to have a specific plan to improve information. Nor is it likely one would be feasible in the short term. Although improving information about price and quality is listed as one of the seven major elements of the President's plan, the White House fact sheet that describes the plan merely states: "The President urges medical providers and insurance companies to make information about prices and quality readily available to all Americans prior to the time of service or treatment."¹⁸

Second, "consumer-driven health care" does not provide a pooling mechanism to enable people with pre-existing conditions and other chronic health problems to buy affordable insurance in the individual market. And as discussed above, the President's proposal would undermine pooling by weakening employer-based group insurance.

When asked about this problem at a press briefing on February 1, National Economic Council Director Allan Hubbard essentially admitted it is a problem that does not yet have a solution:

"At the same time, there is the problem of people with chronic illnesses who do not get their insurance through their employer finding cost-effective and affordable insurance. That's one of the big problems facing this country. Another one of the President's proposals which you'll be able to read about in the budget next week is a pilot program of \$500 million a year that will give the Secretary of HHS the

¹⁶ Linda J. Blumberg, Lisa Clemans-Cope, and Fredric Blavin, "Lowering Financial Burdens and Increasing Health Insurance Coverage for Those with High Medical Costs," Urban Institute, December 2005.

¹⁷ Remarks on Center on Budget and Policy Priorities conference call for journalists, January 31, 2006.

¹⁸ White House, *op cit*.

opportunity for up to 10 states to offer a pilot grant as they develop new approaches to dealing with the chronically ill who are buying insurance at the individual level.”¹⁹

This is a critical question that should be answered *before* proceeding with major new incentives to explain HSAs and shift people from employer-based group coverage to the individual market. The Administration’s only response seems to be to offer a relatively small amount of money for some pilot projects to experiment with approaches that might turn out not to be effective.

The President’s Proposal Would Increase the Deficit

The President’s HSA-related tax proposals would be very costly. The Administration proposes no mechanism, however, to pay for these costs.

These proposals would cost \$156 billion over the ten years from 2007 to 2016. The provisions discussed in this paper, which are disproportionately targeted at high-income families, would constitute the bulk of that sum — \$132 billion over ten years. Even so, the costs over the coming decade will mask the proposals’ true long-term costs. If an individual would have contributed to a 401(k) but shifts the money to a HSA instead, the official budget scoring will show little cost in the next five or ten years. (There will be some cost because the HSA contributions would carry with them a tax credit as well as a deduction, while 401(k) contributions enjoy only a deduction.) But over time, if the HSA withdrawals are used for health care expenses in retirement, they will be entirely tax free. In contrast, the 401(k) withdrawals they displace would have been taxed. As a result, these proposals would cause substantial revenue losses in future decades, at the very time that the nation’s fiscal challenges are growing enormously.

In his State of the Union address, the President stated, “the rising cost of entitlements is a problem that is not going away.” These new and expanded health tax breaks would represent an expansion of what former Federal Reserve Chairman Alan Greenspan once described as “tax entitlements,” exacerbating the very challenge the President identified.²⁰

Although the President is apparently offering no proposals to pay for the additional deficits his HSA tax proposals would engender, these higher deficits eventually would have to be paid for somehow. If the eventual plan to cover the higher deficits these proposals would cause includes Medicaid and Medicare cuts, the impact on the health insurance system would be still more problematic and the net effect would likely be even more regressive.

Conclusion

Some 46 million Americans have no health insurance, and the health care system is not delivering sufficiently high-quality, cost-effective care to many other Americans. The President’s proposals do

¹⁹ White House Office of the Press Secretary, “Press Briefing on the President’s Health Care Initiatives For 2006,” February 1, 2006.

²⁰ Federal News Service, “Transcript of the Hearing of the Bipartisan Commission on Entitlements and Tax Structure Reform,” July 15, 1994.

not address these challenges. Instead, he is proposing a costly plan that would increase deficits while favoring healthy, affluent individuals and weakening existing sources of health insurance.

Part of the problem with the existing health care system is that it is based on a set of costly, rather regressive, and sometimes counterproductive tax breaks related to employer-provided health insurance. Rather than curbing existing tax incentives for overly generous health plans and retargeting some of those government subsidies to expand health insurance for those who lack it, the Administration is proposing even more costly, regressive, and potentially counterproductive tax breaks. The Administration's proposal to "level the playing field" through regressive health-related tax cuts would break down the one health care pool that provides coverage for the vast majority of Americans – the employment-based system – without replacing it with another mechanism to pool risk across healthy and less-healthy individuals.

Another problematic aspect of the existing health care system is that consumers are not sufficiently cost conscious. The President's proposal lacks the necessary components, however, to help consumers become more cost conscious, including measures to provide the necessary information about price and quality.

Finally, the President's plan provides incentives for high-income families to shift into plans with higher deductibles while leaving moderate-income families in lower tax brackets with much more limited tax incentives. Moderate-income families that lost employer-based coverage as a result of these proposals could face less adequate coverage options than they currently have.

Taking the title of Cogan, Hubbard, and Kessler's book out of context, the President's proposals might be a good deal for the healthy, wealthy and wise, but they would pose significant problems for millions of other Americans, especially those who have modest incomes or significant medical conditions.