CENTER ON BUDGET AND POLICY PRIORITIES

# NEWS RELEASE

820 First Street, NE, Suite 510
Washington, DC 20002

Tel: 202-408-1080
Fax: 202-408-1056

center@cbpp.org
www.cbpp.org



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CONTACT: Henry Griggs
202-408-1080

## PROPOSED TAX DEDUCTION FOR HEALTH SAVINGS ACCOUNTS WOULD CAUSE RANKS OF UNINSURED TO EXPAND

Analysis by one of the nation's leading health economists finds that a Bush Administration proposal which Congress may soon consider would likely increase the number of uninsured Americans by 350,000 while costing the Treasury $25 billion over ten years.

The analysis, conducted by Jonathan Gruber of M.I.T. and reported in a new study from the Center on Budget and Policy Priorities, examines a proposal to allow people with Health Savings Accounts to claim a tax deduction for the premium costs of high-deductible health insurance policies purchased in the individual health insurance market. (Health Savings Accounts can be used only in conjunction with high-deductible policies.) A Senate Republican task force on the uninsured that is due to report this week is considering this proposal (the task force is expected to issue its recommendations on how to expand health insurance coverage in conjunction with "Covering the Uninsured" week), and Treasury Secretary Snow is likely to promote the proposal at a Senate Aging Committee hearing on Health Savings Accounts next week.

Gruber found that the proposed tax deduction would induce some currently uninsured individuals to purchase insurance, but also would encourage some employers to drop health insurance or to reduce the amounts they contribute toward their employees' health insurance costs, since employers would know their workers could get a tax deduction if they purchased coverage on their own. The number of people who would lose coverage due to actions that their employers would take would likely exceed the number of uninsured people who would gain insurance, Gruber concluded.

Commenting on these findings, Center executive director Robert Greenstein observed: "This proposal would manage to spend $25 billion while making the problem of the uninsured worse and providing the largest tax subsidies to already-insured people in the highest tax brackets, the people who least need government subsidies to afford insurance. As a result, the proposal could be considered an example of government waste, with the wasteful subsidy being provided through the tax code in this case."

### Deduction Would Be Worth Little to Most Uninsured People

A key reason for this finding is that the deduction would be worth little to the approximately 90 percent of uninsured people who either are in the 10 percent or 15 percent tax brackets or earn too little to owe income tax. The proposed tax deduction would reduce the costs of health insurance by zero to 15 percent for such households, leaving them to bear 85 percent to 100 percent of health insurance premium costs themselves. For most uninsured low- and moderate-income people, health insurance would remain unaffordable. Gruber found that the bulk of the people who would use the tax deduction are people who already can afford and have purchased insurance. Some 87 percent of those who would use the deduction would already be insured, Gruber estimated.

A large share of these individuals would be people in high tax brackets. The deduction would subsidize 3½ times as large a share of the costs of health insurance coverage for a family that earns $3 million a year — and is in the 35 percent tax bracket — as for a family that makes $30,000 a year and is in the 10 percent tax bracket.

In total, Gruber estimated that just under eight million taxpayers would use the proposed deduction, 6.9 million of whom would already be insured. He also projected that employers who currently cover 2.1 million workers would drop coverage as a result of the deduction and that some additional employers would retain coverage but substantially reduce their employer contributions for it, leading some of their workers to drop out. Some of the workers who no longer would be covered through their employer would purchase coverage in the individual market, but many would not — and 1.4 million workers currently covered through their employer would become insured. The net result would be a rise of approximately 350,000 in the ranks of the uninsured.

Professor Gruber's sophisticated models for analyzing the effects of proposals on health insurance coverage levels are widely respected and widely used.

**Projected Effects of Fiscal Year 2005 Administration HSA Deduction Proposal**

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|---|---|
| Projected number of people who would claim the tax deduction | 7.98 million |
| Number of claimants who would previously have had health insurance coverage | 6.91 million (87%) |
| Number who would previously have been uninsured and would gain coverage | 1.07 million (13%) |
| Number who would previously have had employer-based coverage but would become uninsured as their employers dropped coverage or reduced their premium contributions | -1.41 million |
| **Net effect on number of individuals with health insurance coverage** | **-350,000** |
| * Estimates by Jonathan Gruber, M.I.T. Numbers may not add precisely due to rounding. | |

### Mounting Costs of HSAs Contributing to Rise in Cost of Medicare Drug Bill

The Center's analysis also notes that the cost of the proposed tax deduction, which both the Administration and the Joint Committee on Taxation peg at about $25 billion over ten years, would bring the total costs associated with Health Savings Accounts to $41 billion over ten years. The Administration estimates that the provision of the Medicare drug bill enacted last fall that established Health Savings Accounts will cost $16 billion over this period.

The official, $400-billion Congressional Budget Office cost estimate of the drug bill that Congress relied on in passing that legislation assumed the bill's HSA provisions would cost only about $6 billion over ten years. That estimate was based on the assumption that use of HSAs would be modest. Given the aggressive marketing of HSAs that is underway and recent employer surveys indicating considerable interest in offering HSAs, most analysts now believe the $6 billion estimate was much too low and that the $16 billion estimate in the Administration's current budget is a sounder projection (although even the Administration's projection may underestimate the actual 10-year cost of HSAs).

The tax deduction now being proposed would, if enacted, cause HSA use to become still more widespread, since the deduction would enhance the already-generous tax benefits that HSAs offer, especially to people in the top income tax brackets. HSAs already provide a lucrative tax break; they are the only feature of the tax code that provides for *both* tax-deductible deposits into accounts *and* tax-free withdrawals from those accounts. The Administration's new proposal would provide an additional deduction, on top of these tax breaks, to people who use HSAs and purchase high-deductible policies in the individual health insurance market.

The increased use of HSAs — and HSA tax breaks — that the proposed deduction would engender is reflected in the proposal's $25 billion price tag. As noted, the deduction would bring the total claim of HSAs on the federal Treasury to $41 billion over the next ten years. That would be more than six times the $6.4 billion cost for HSAs that was included in the official cost estimate for the Medicare drug bill last fall.

The Center's report explains that passage of the proposed deduction also would result in revenue losses for *state* governments and would thereby enlarge the budget deficits that numerous states continue to face. For simplicity's sake, state income tax codes generally conform to the definition of taxable income in the federal income tax code. Inserting this deduction into the federal code thus would effectively write the deduction into many state tax codes as well.

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