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A BRIEF OVERVIEW OF THE MAJOR FLAWS WITH HEALTH SAVINGS ACCOUNTS

Established under the 2003 Medicare drug legislation, Health Savings Accounts (HSAs) are individual accounts in which individuals who have a high-deductible health policy can save money to pay out-of-pocket health expenses. In tax year 2006, any individual who enrolls in a health plan with a deductible of at least \$1,050 for individual coverage and \$2,100 for family coverage may establish an HSA. Contributions to HSAs are tax deductible and may be placed in stocks, bonds, or other investment vehicles, with the earnings accruing on a tax-free basis. Withdrawals from HSA also are tax exempt as long as they are used for out-of-pocket medical costs.

To encourage more people to open HSAs, the Administration is proposing substantial new HSA tax subsidies, such as providing a tax credit as well as a deduction for contributions to HSAs, making the premium costs for HSA-related health plans purchased in the individual market tax deductible (and providing refundable tax credits for them as well), and increasing the amount that can be deposited in a HSA each year to \$5,250 for an individual and \$10,500 for a couple or family. In total, the Treasury estimates that the President's proposals would cost \$156 billion over ten years.

These proposals — and HSAs in general — suffer from several serious problems:

HSAs would weaken the existing health insurance system and could actually *increase* the number of uninsured.

- The vast majority of Americans receive health coverage through the employer-based system, under which healthier and sicker employees are combined into a single insurance pool. This “risk pooling” facilitates affordable coverage for everyone. If each individual had to purchase insurance individually based on his or her own health status, many sicker workers would be priced out of the market or would be unable to buy coverage at any price.
- HSAs, however, encourage healthier and wealthier people to switch from comprehensive, low-

For further detail on the issues discussed here, see the following reports, available on the Center's website: Edwin Park and Robert Greenstein, “Administration Defense of Health Savings Accounts Rests on Misleading Use of Statistics [<http://www.cbpp.org/2-16-06health.htm>],” February 16, 2006; Jonathan Gruber, “The Cost and Coverage Impact of the President's Health Insurance Budget Proposals [<http://www.cbpp.org/2-15-06health.htm>],” February 15, 2006; Jason Furman, “Expansion in HSA Tax Breaks Is Larger — and More Problematic — Than Previously Understood [<http://www.cbpp.org/2-4-06tax.htm>],” revised February 7, 2006; Edwin Park and Robert Greenstein, “Latest Enrollment Data Still Fail to Dispel Concerns About Health Savings Accounts [<http://www.cbpp.org/10-26-05health2.htm>],” revised January 30, 2006.

deductible coverage to high-deductible health plans in order to take advantage of the unprecedented tax shelters that HSAs provide. (No other savings account offers both tax-deductible contributions *and* tax-free withdrawals.) As healthier and wealthier workers leave comprehensive employer-based plans to take advantage of the HSA tax benefits, the pool of workers remaining in those employer-based plans would consist increasingly of sicker, less-affluent people, (<http://www.cbpp.org/10-26-05health2.htm>) who are more costly to cover. As comprehensive employer-based coverage became increasingly costly, more and more employers likely would stop offering it.

- A new analysis (<http://www.cbpp.org/2-15-06health.htm>) by Jonathan Gruber of M.I.T., one of the nation's leading health economists, finds that the Administration's new HSA proposals would cause a net *increase* in the number of uninsured Americans. While 3.8 million previously uninsured people would gain health coverage through HSAs as a result of the Administration's proposals, 4.4 million people would become uninsured because their employers would respond to the new tax breaks by dropping coverage and they would not secure coverage on their own. The net effect would be to increase the number of uninsured Americans by 600,000 despite spending more than \$10 billion annually.

HSAs shift risks to individuals, leave less-healthy individuals facing substantial costs, and potentially result in worse health outcomes.

- For people who need more health care, the high-deductible insurance policies that must be used in conjunction with HSAs can mean significantly greater out-of-pocket medical costs than they would face under the comprehensive health insurance typically offered today, which usually carries significantly lower deductibles. According to the Kaiser Family Foundation and the Health Research Educational Trust, the average deductible for an HSA-qualified family plan offered by employers in 2005 was \$4,070, as compared to an average deductible of \$679 for a preferred provider organization (PPO) plan.
- In 2005, individuals with high-deductible plans attached to HSAs or similar accounts were more than two-and-a-half times as likely to pay more than 5 percent of their income in out-of-pocket medical costs (<http://www.cbpp.org/10-26-05health2.htm>) than were people enrolled in comprehensive insurance, according to a recent survey by the Employee Benefit Research Institute and the Commonwealth Fund.
- These increased out-of-pocket costs are particularly burdensome for lower-income families because they have less disposable income. If a medical condition or illness goes untreated because individuals are unable to pay for appropriate care out of pocket, their health could decline further, forcing them to make greater use of expensive services like hospitalization in the future. As President Bush's Council of Economic Advisers (CEA) itself acknowledged, the greater cost sharing could result in worse health outcomes for low-income families.¹

¹ According to CEA, "There were, however, some health benefits [from reduced cost sharing and greater health expenditures] for select subpopulations of low-income and chronically ill individuals, suggesting that care should be taken not to expose lower-income families to excessively high cost sharing relative to their income." CEA, *Economic Report of the President 2006*, p. 95.

HSAs have little potential to improve the health insurance system.

- HSA proponents argue that by shifting more of the costs onto individuals, high-deductible plans will lead people to become wiser health consumers. The HSA approach has limited potential for cost containment, however, because most of the nation's health-care costs 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, while the bottom 50 percent of users account for only three percent of total expenditures.
- More fundamentally, for consumer-driven health care to have any potential, consumers must have access to easily digestible comparative and clinically based information on the quality and costs of different doctors and hospitals, as well as information on which medical procedures are (and are not) necessary in particular circumstances. Also, a pooling mechanism must exist that enables less-healthy people to purchase insurance at an affordable price. No serious plan yet exists to address either of these needs. (<http://www.cbpp.org/2-4-06tax.htm>)

HSAs provide the largest tax breaks to those who *least* need help paying for health coverage.

- Higher-income people receive a larger tax break for each dollar they put into an HSA than lower-income people do because they are in a higher tax bracket. For example, someone in the 35-percent tax bracket saves 35 cents in taxes for each dollar he or she puts into an HSA, while someone who is in the zero, 10-percent, or 15-percent bracket saves no more than 15 cents in taxes for each dollar put into the account.
- In addition, higher-income people generally can afford to put more money into HSAs each year than lower-income people can, which makes HSAs even more valuable to them. The Administration's proposal to substantially increase the HSA contribution limit would exacerbate this disparity and enable affluent households to use HSAs as highly lucrative tax shelters, (<http://www.cbpp.org/2-4-06tax.htm>) in which they could amass hundreds of thousands of dollars tax free.
- Attempting to counter the fact that HSAs are disproportionately attractive to high-income households, Administration officials have cited a study showing that families with incomes lower than \$50,000 buy 40 percent of the insurance policies bought in conjunction with HSAs. This study, however, cannot be used to draw general conclusions about HSAs (<http://www.cbpp.org/2-16-06health.htm>) because it applied to only a portion of HSA enrollees: those in the individual health insurance market, who generally have lower incomes than HSA enrollees who have employer-based coverage.

Other studies show that HSA users tend to disproportionately have higher incomes. For example, a new Government Accountability Office survey finds that federal employees who receive insurance through the Federal Employee Health Benefits Program (FEHBP) and are enrolled in an HSA are twice as likely to have incomes over \$75,000 as enrollees in other FEHBP plans (<http://www.cbpp.org/2-16-06health.htm>).

HSA's would significantly increase the federal budget deficit, especially in future decades when the nation already will be under fiscal strain.

- The Administration estimates that its new HSA proposals would cost \$156 billion over ten years. (<http://www.cbpp.org/2-4-06tax.htm>) This cost would be “paid for” through higher deficits, since the Administration has offered no way to offset the cost of these proposals.
- Even this significant \$156 billion estimate understates the true costs of the proposals over the longer term. The Administration’s proposals would encourage households — especially affluent households that can afford to save larger amounts — to shift part of their savings from 401(k)s and IRAs to HSAs in order to benefit from the latter’s greater tax advantages. (For example, HSAs can be withdrawn tax free in retirement if they are used for health-related expenses, while 401(k) withdrawals are taxed.) In future decades, as more and more funds that would have been saved in 401(k)s and taxed upon withdrawal are saved in HSAs instead and withdrawn tax free, the costs of these proposals would mushroom.

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. Health Savings Accounts do not address these challenges. Instead, they would increase deficits while favoring healthy, affluent individuals and weakening existing sources of health insurance.