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HEALTH SAVINGS ACCOUNTS UNLIKELY TO SIGNIFICANTLY REDUCE HEALTH CARE SPENDING

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Proponents of Health Savings Accounts (HSAs) — tax-favored savings accounts attached to high-deductible health insurance plans — have long argued that widespread adoption of HSAs will contain health care costs substantially over time. The theory is that the high deductibles required under HSAs (at least $1,050 for individuals and $2,100 for family coverage in 2006) will encourage individuals to be more prudent consumers since they will now be responsible for the cost of health care below the deductibles and therefore will be more likely to limit use to necessary, cost-effective services. To further spur enrollment in HSAs, the Administration has proposed new tax cuts expanding HSAs, which the Treasury projects will cost $156 billion over ten years, and the House of Representatives may consider these proposals on the floor during the House leadership's "Health Week" later this month.[1]

This brief analysis indicates, however, that HSAs are unlikely to reduce overall health care expenditures to any significant extent. The analysis also finds that to the limited extent HSAs may cause some modest reduction in health care spending, any such reduction is likely to result in no small part from individuals — particularly those with lower incomes — forgoing cost-effective medical services including primary care, prescription drugs, and preventive services.

- **The vast majority of the nation's health care spending would not be affected by the high deductibles required under HSAs.** There is limited potential for cost containment 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 — the costs of which exceed the high deductibles required under HSAs and consequently would still be paid for by health insurance plans. One study has determined that 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.[2] Another study found that more than 95 percent of medical

[1] The Joint Committee on Taxation estimates the cost of the Administration's HSA proposals at $108 billion over 10 years. For an analysis of these proposals, see Jason Furman, "Expansion in HSA Tax Breaks Is Larger — and More Problematic — Than Previously Understood," Center on Budget and Policy Priorities, Revised February 7, 2006 and Jonathan Gruber, "The Cost and Coverage Impact of the President's Health Insurance Budget Proposals," Center on Budget and Policy Priorities, February 15, 2006.

[2] Alan C. Monheit, "Persistence in Health Expenditures in the Short Run: Prevalence and Consequences," *Medical Care* 41, July 2003 Supplement, cited in Karen Davis, Michelle Doty and Alice Ho, "How High Is Too High? Implications of High-Deductible Health Plans," The Commonwealth Fund, April 2005.

expenditures by working-age households with health insurance were made by those who spend above the minimum HSA deductibles, and that overall, nearly 79 percent of total medical expenditures occurred above the minimum HSA deductibles.[3]

- **Because most health care spending occurs well above the high deductibles required under HSAs, numerous health policy analysts have concluded that HSAs are unlikely to produce significant reductions in overall health care spending.** For example, the Congressional Research Service states that "it would be unreasonable to expect [HSAs] to produce a significant reduction in the nation's health care costs."[4] An analysis for the National Health Policy Forum also notes that HSAs "seem unlikely to reduce the overall level of expenditures very much... [and it] is doubtful that health care costs would moderate much if the 25 percent of the population accounting for most of the spending all had high-deductible health plans and HSAs."[5] Similarly, an analysis issued by the Urban Institute-Brookings Institution Tax Policy Center (authored by TPC director Leonard Burman and Urban Institute health care expert Linda Blumberg) points out that "even if HSAs were to eventually cover all working-aged households, they would have little effect on medical spending. Households spending more than the deductible, are on the margin, reimbursed by insurance — just like current insured — and would face little or no additional incentive to economize."[6] In the same vein, a Commonwealth Fund analysis concludes that HSAs are "unlikely to affect health care outlays significantly."[7] Finally, the benefits consultant Watson Wyatt believes that high-deductible health plans attached to HSAs are unlikely to curb employers' health care costs because most of firms' health care spending is incurred by a small percentage of individuals with serious health conditions, who would unaffected by the high deductibles.[8] Even the Administration's own actuaries at the Centers for Medicare and Medicaid Services believe that new developments in private insurance coverage such as HSAs, as well as disease management programs, will have a relatively small net impact on health care cost containment.[9]

- **In addition, to some degree, the availability of HSAs may actually increase health care spending.** HSAs provide a new tax subsidy for out-of-pocket medical costs. Prior to the establishment of HSAs by the 2003 Medicare prescription drug law, only certain limited tax breaks were available for out-of-pocket medical spending.[10] Under HSAs, however, contributions made to a HSA, earnings on investments of the funds held in a HSA, and

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[3] Linda Blumberg and Leonard Burman, "Most Households' Medical Expenses Exceed HSA Deductibles," *Tax Notes*, August 16, 2004.

[4] Bob Lyke, Chris Peterson and Neela Ranade, "Health Savings Accounts," Congressional Research Service, Updated March 23, 2005.

[5] Beth Fuchs and Julia James, "Health Savings Accounts: The Fundamentals," National Health Policy Forum, April 11, 2005.

[6] Blumberg and Burman, *op cit*.

[7] Davis, Doty and Ho, *op cit*.

[8] Watson Wyatt, "Financial Incentives Alone Unlikely to Curb Health Care Costs, Watson Wyatt Says," April 24, 2006.

[9] Christine Borger, Sheila Smith, Christopher Truffer et al., "Health Spending Projections Through 2015: Changes on the Horizon," *Health Affairs*, Web Exclusive, February 22, 2006.

[10] For example, a tax deduction is available for out-of-pocket medical costs in excess of 7.5 percent of adjusted gross income (AGI). In addition, if offered by a firm, an employee can contribute pre-tax dollars to a Flexible Spending Account to pay for out-of-pocket medical costs incurred during the year.

withdrawals from a HSA to pay for out-of-pocket medical costs all are tax-free. As a result, practically any medical expense paid for with funds held in a HSA now receives a tax subsidy, including benefits and some elective procedures that are *not* typically covered by health insurance plans as well as benefits that often are restricted in their amount, duration and scope.[11] For example, health insurers often require individuals to get prior approval before a specialty service is covered by the insurance plan or set limits on how many of those services may be provided annually. As a result, tax-favored HSAs could encourage some HSA enrollees to obtain additional health care services they would not otherwise use, and thereby to increase these enrollees' health care expenditures.

- **Low-users of health care who could be affected by the high deductibles already incur significant cost-sharing, so HSAs are not likely to produce much savings among this population.** Individuals who do not use much in the way of health care may have health care spending that could be affected by the high deductibles required by HSAs. (One study estimates, however, that individuals who spend less than the minimum HSA deductible account for less than 6 percent of total health care expenditures for individuals and less than 4 percent of family expenditures.[12]) But a recent study by the Kaiser Family Foundation determined that much of the spending by this population already is subject to sizable cost-sharing through coinsurance and existing, lower deductibles. For example, non-elderly individuals with private insurance who were in the bottom 80 percent of health care users paid, on average, 76 percent of the cost of vision care on an out-of-pocket basis, 59 percent of the cost of home health care, 54 percent of the cost of prescription drugs, and 30 percent of the cost of office visits.[13] In other words, these low-users of health care are subject to significant out-of-pocket costs that already discourage them from using many health care services. As a result, the high deductibles would only somewhat increase financial disincentives for these low-users to seek medical care and therefore would be likely to have only a limited impact among the population of low-users.

- **To the extent that there are any reductions in health care spending, it likely is due in significant part to reductions in the use of cost-effective medical services, such as primary care, prescription drugs and preventive services, with a disproportionate impact on low-income individuals and families.** Among the medical services whose costs are generally below the minimum HSA deductibles are services that many experts consider to be the most cost-effective. Examples include primary care services such as physician visits that diagnose and provide low-cost treatment of acute conditions (like an ear infection for children or a urinary tract infection) and maintenance drugs that manage or treat chronic conditions like diabetes.[14] In addition, while the high-deductible plans attached to HSAs may exempt preventive care services like diagnostic tests and screenings from the high deductible, there is

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[11] For a list of allowable out-of-pocket medical expenses, see Internal Revenue Service, "Publication 502: Medical and Dental Expenses," 2005.

[12] Blumberg and Burman, *op cit.*

[13] Kaiser Family Foundation, "Snapshots: Distribution of Out-of-Pocket Spending for Health Care Services," May 2006, available at www.kff.org/insurance/snapshot/chcm050206oth.cfm.

[14] Davis, Doty and Ho, *op cit.* The Commonwealth Fund analysis also notes that "studies tend to find underutilization of preventive and primary care services, while overutilization tends to occur with "big ticket" items such as surgery, imaging and diagnostic tests, end-of-life care, and specialty consultations," all services whose costs exceed the minimum HSA deductibles.

no requirement that such plans actually do so.[15] In its 2005 employer survey, the Kaiser Family Foundation and the Health Research Educational Trust found that only 30 percent of workers enrolled in a high-deductible plan that qualified for a HSA had some preventive benefits exempt from the deductible.[16] The effect of the high deductibles required under HSAs on the use of such services is likely to be particularly pronounced among lower-income individuals and families because they have less disposable income and therefore are more sensitive to increases in their out-of-pocket medical costs.[17] Even President Bush's own Council of Economic Advisers acknowledges that greater cost-sharing among such households could result in worse health outcomes for low-income families.[18] If a medical condition or illness goes untreated because lower-income individuals are unable to pay out-of-pocket for appropriate primary care or prescription drugs, their health could decline, forcing them ultimately to make greater use of costly services like emergency room visits or hospitalization. As a result, to the extent that low-income individuals and families fail to use preventive care, primary care, prescription drugs, or other cost-effective, lower-cost services, HSAs could actually drive up the health-care costs that such people incur.

[15] IRS guidance indicates that some prescription drugs may meet the preventive care definition such as cholesterol-lowering drugs taken by an individual without heart disease to prevent the future occurrence of heart disease (though it is unclear if any high-deductible health insurance plans do so), but the preventive care exemption does not encompass prescription drugs used to treat an existing illness, injury or condition. See Internal Revenue Service, "Internal Revenue Bulletin: 2004-33," August 16, 2004.

[16] Gary Claxton, Jon Gabel, Isadora Gil et al., "What High-Deductible Plans Look Like: Findings from a National Survey of Employers, 2005," *Health Affairs*, Web Exclusive, September 14, 2005.

[17] At the same time, the high deductibles would most likely be too low to significantly affect health care utilization of such services by higher-income individuals. See, for example, Martin Feldstein and Jonathan Gruber, "A Major Risk Approach to Health Insurance Reform," *Tax Policy and the Economy*, James Poterba (ed.), Chicago: University of Chicago Press, 1995.

[18] According to CEA, "There were, however, some health benefits [from reduced cost-sharing and greater health spending] 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." Council of Economic Advisers, "Economic Report of the President: 2006," February 13, 2006, p.95.