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Health Savings Accounts Can Make Employers, Employees and State Governments Feel Better

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One of the positive aspects of the recent Medicare Drug Bill was a provision allowing the establishment of tax-free Health Savings Accounts (HSA's). These accounts may become more important than ever as employers and state governments look for ways to maintain health care quality while keeping costs under control.

Health Savings Accounts are used to pay for low-dollar medical expenses. They are linked to a high-deductible catastrophic insurance plan that protects employees from major illnesses. Unused funds roll over to the next year and belong to the employee. Since individuals are spending their own money on health care under this type of coverage they may be expected to economize on unneeded medical expenditures.

For example, suppose a family medical plan with no deductible and/or co-pay costs $7,500 per year. A plan with a deductible of $4,000 might cost $5,000 per year. Thus, an employer could take the premium savings of $2,500 and deposit it in an HSA for employees. The family now must pay the first $4,000 ($2,500 from their HSA and $1,500 out of pocket) in expenses, creating powerful incentives to use medical care more carefully. That reduced utilization along with lower administrative costs make HSA's a cost-effective alternative to traditional health insurance.

Critics have focused on three major issues. First, they argue individuals will not change their behavior when faced with high-deductible insurance because health care is "different". Data from Aetna Insurance Health Fund Plan using a less flexible form of HSA's (the HRA), however, found that higher deductibles reduced insurance costs increases from 10 percent or more for traditional plans to just 3.7 percent. The slow growth was driven by a reduction in primary care and emergency room visits along with fewer inpatient and outpatient visits. Health care account holders also reduced prescription drug use by 13 percent and relied more on generic drugs than under other plans.

This leads to the second criticism: Incentives to reduce health-care costs will reduce preventative care. But adult preventative exams almost tripled under the HRA Plan compared to traditional coverage. In many cases, the savings accounts gave patients more flexibility over where their money could be used and they used it for preventative care. Gynecological exams, child preventative visits and diabetes testing increased.

Thus, health savings accounts helped individuals use health care more effectively; they reduced utilization of some services while increasing the use of others (such as preventative care).

Earlier studies by the Rand Corporation showed similar results: Consumers with higher deductibles used 30 percent less health care with no significant differences in health outcomes.

A third criticism claims that HSA's will discriminate against the "sick". HSAs carry an out of pocket risk that might be higher than traditional plans, especially for the chronically ill. Studies from the National Bureau of Economic Research show that 10 percent of the population accounts for 80 percent of health spending in any given year. So, on the surface, critics seem to have a point. But over a normal work life of 35 years, 55 percent of individuals account for 80 percent of expenses. Thus, the same people are not ill each year. Most people may be very sick one year but recover (for example, heart bypass surgery).

This finding produces a powerful argument for health savings accounts. Since most people are not sick every year, the overwhelming majority of participants in an HSA Plan would have unused funds at age 65. In fact, NBER found that over 90 percent of workers would have accumulated balances. These unused monies could be used for other expenses just like drawing on funds from a 401(k) plan.

Over several years the number of individuals without a positive HSA balance is so small most employers could simply cover those out of pocket costs.

Therefore, for the same price as traditional health insurance, employers can now offer HSA plans that protect chronically ill workers while giving most other employees an effective employer-funded 401(k) plan!

The major impediment to this type of coverage in the past was that HSA funds would be taxed when placed into the account. The new legislation eliminated this problem and makes coverage available to all non-Medicare individuals. In addition, the success of these programs show promise as a major reform of the budget-busting Medicaid program.

HSA's lower costs, increase freedom of choice and produce better health outcomes. Now that's a health care plan that will make us all feel better.

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