HSAs Won’t Cure Medicare’s Ills

By Leonard Burman and Linda Blumberg

Here’s one message from the new “bipartisan” Medicare bill currently being debated in Congress: Low-income elderly people are having a hard time paying for their prescription drugs, so we need… another tax cut for rich people!

Give tax slashers credit for staying on message. Another tax cut for rich people was also the solution to war, international terrorism, economic recession, and "double taxation" of company earnings. Next month, President Bush will propose tax cuts as the cure for inadequate personal savings.

Today’s tax cut for rich people—health savings accounts (HSA)—has been all but lost in the debate about the proposed new Medicare prescription drug benefit, but this wolf in sheep’s clothing shouldn’t be overlooked. It is bad tax policy and bad health policy.

The details of the current incarnation of HSAs are not yet public. The House-passed version would allow people covered by high-deductible health insurance policies to make tax-deductible contributions of up to $2,250 per year in a health savings account. People with family coverage could sock away $4,500. Those 55 and over could put in more. Money in the account and any earnings would be tax-free if used to cover medical costs.

Conservatives have been peddling health savings accounts as a market-based solution for health market woes for at least a decade. Indeed, an “experimental” version, known as medical savings accounts, have been available since 1996 for the self-employed and workers in small firms. These accounts haven’t proven popular, but that is because they are limited. Universal health savings accounts would be a boon to the healthy and wealthy, and a bane to everyone else.

These accounts would represent a $6.7 billion tax subsidy over the next decade, according to official estimates, and possibly much more if utilization turns out to be higher than the estimators expect. The big winners would be high-income people who are healthier than average. The losers include Medicare beneficiaries, whose drug benefit had to be trimmed to make room for this tax windfall, and working aged people with lower incomes or costly chronic health conditions.

If health savings accounts prove popular, as Congressional scorekeepers expect, low-deductible insurance will gradually become more expensive, or even disappear. That would hurt the low income and the sick.

To see why, consider the story of Blue Cross high option health insurance. For years, federal employees had a choice of “high option” Blue Cross health insurance and a “standard option” with a slightly lower deductible and a few other limitations. For the typical federal employee, high option was worth a little more, and initially premiums were slightly higher. Young, healthy employees risked having to pay the higher deductible in exchange for the small premium difference. Older, sicker employees preferred high option. But the premium difference grew larger over time as more healthy people shunned the high option. When last offered in 2001, the Blue Cross high- option family premium was $1,500 more than standard option. In 2002, high option was dropped from the plan.

Tax-subsidized health savings accounts combined with high-deductible plans set up the same kind of incentives when competing with traditional plans. Worse, the differences in deductibles will be significant from the get-go—at least $2,000 per family for the more comprehensive plan. By comparison, traditional family coverage has significantly lower deductibles, and typically no deductible for care provided by in-network physicians.

This proposed set-up would primarily benefit those with high incomes for at least two reasons. First, the tax deduction is worth most to them. A $4,500 HSA contribution, the maximum permitted in the House legislation, would generate a tax deduction worth $1,575 per year to a household in the top income tax bracket. The value of the tax benefit would be less than half as much for a moderate-income family—much less if it could not afford to contribute much to the account.

Second, high-income people can afford the risk of a high deductible. $2,000 in unreimbursed medical costs is a huge burden for someone earning $30,000 per year, but chump change for someone earning $300,000. Employers may kick in part of the deductible out of their premium savings, but those savings are expected to be dwarfed by the deductible. Thus, modest-income families in these high- deductible plans may be tempted to skip preventive care or delay medical tests and services when illness strikes.

Tax cuts for rich people were never a cure-all, but this particular proposal is pure snake oil. Health savings accounts have nothing to do with Medicare and they are the wrong prescription for the uninsured. ##

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