



**BRIEF ANALYSIS**

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## Health Savings Accounts Will Revolutionize American Health Care

by John C. Goodman

The idea behind Health Savings Accounts (HSAs) is quite simple. Individuals should be able to manage some of their own health care dollars through accounts they own and control. They should be able to use these funds to pay expenses not paid by third-party insurance, including the cost of out-of-network doctors and diagnostic tests. They should be able to profit from being wise consumers of medical care by having account balances grow tax free and eventually be available for nonmedical purchases.

As of January 1, 2004, 250 million nonelderly Americans now have access to HSAs, provided they are combined with catastrophic insurance.

### Creating a Level Playing Field for Individual Self Insurance.

Health Savings Accounts are designed to help correct a major flaw in tax law that distorts our entire health care system.

Every dollar an employer pays for employee health insurance premiums avoids income and payroll taxes. For a middle-income employee, this generous tax subsidy means that government is effectively paying for almost half the cost of the health insurance. [See Figure I.] On the other hand, the government taxes away almost half of every dollar employers put into savings accounts for employees to pay their medical expenses directly. The result is a tax law that lavishly subsidizes third-party insurance and severely penalizes

individual self-insurance. This encourages people to use third-party bureaucracies to pay every medical bill, even though it often makes more sense for patients to manage discretionary expenses themselves.

The new law, part of the recently enacted Medicare prescription drug bill, gives deposits to HSAs the same tax advantages formerly granted only to health insurance premiums. Employer and employee deposits to HSAs will avoid all federal income and payroll taxes.

When combined with individually owned insurance, HSA deposits will be a deductible expense, even for income tax filers who do not itemize.

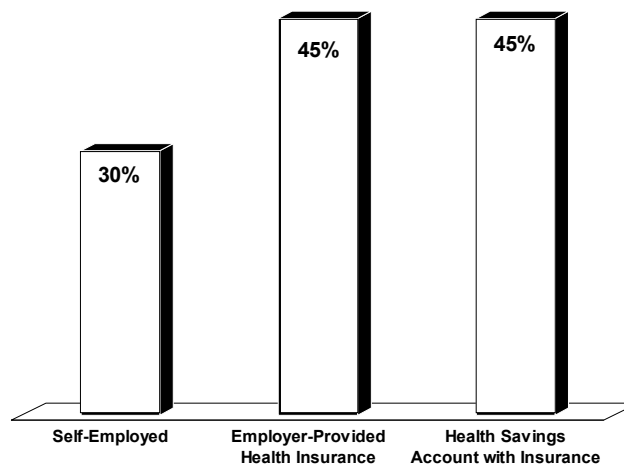
### Making Choices.

Advances in medical science have reached a point where we can probably spend the entire gross domestic product on health care — in useful ways! The Cooper Clinic in Dallas now offers a super-duper checkup (with a full body scan) for about \$2,500 or more. If everyone in America took advantage of this opportunity, we would increase our nation's annual health care bill by one-half. There are more than 900

diagnostic tests that can be done on blood alone, and one doesn't need too much imagination to justify, say, \$5,000 worth of tests each year. But if everyone did that we would double the nation's health care spending. So how do we decide which procedures are worthwhile and which are not?

There are basically only three ways. In other developed countries, these decisions are made either directly or indirectly by government. But government-imposed rationing is arbitrary, inefficient, unfair and probably unacceptable to most Americans. The second method is to restrain spending using managed care techniques. But during the 1990s voters expressed discomfort with

**FIGURE I**  
**Federal and State Tax Subsidies for Health Insurance**



Note: Assumes taxpayer is in the 25 percent federal income tax bracket, faces a 15.3 percent payroll (FICA) tax and a 5 percent state and local income tax.

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having employers and large insurers ration their health care. The third option is to allow individuals to make their own choices between health care and other uses of money, through a vehicle such as HSAs.

### Restoring the Doctor-Patient Relationship.

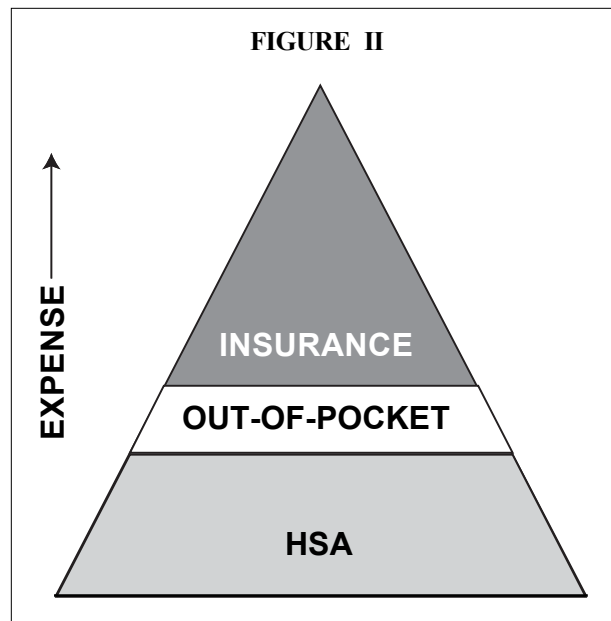
Patients will make better choices if they can rely on doctors who put their interests first. In a managed care world, doctors too often look to employers and insurers for guidance in deciding how to practice medicine. In a very real sense, providers view insurers rather than patients as their customers. With HSAs, however, physicians will be free to act as the agents of their patients.

### Expanding Options.

Since 1996, a pilot program has made Medical Savings Accounts available to small businesses and the self-employed. But because of the many restrictions, only about 70,000 people have these accounts. A U.S. Treasury Department ruling in 2002 allowed large companies to establish Health Reimbursement Arrangements, and at last count, 1.5 million employees had enrolled. But these accounts are also unreasonably restricted. Flexible Spending Accounts offer consumers the chance to withhold funds tax free for medical care. But these have a use-it-or-lose-it feature which requires employees to forfeit unused funds to employers at the end of the year. This forfeiture provision encourages employees to waste money on unnecessary care and makes most people apprehensive about depositing money except when they can precisely predict their future medical needs.

**How HSAs Work.** HSAs will be the most flexible, consumer-friendly accounts yet devised. They will allow individuals and employers to make deposits each year equal to their health insurance

deductible. The health insurance policy that accompanies an HSA must have an overall deductible of at least \$1,000 for an individual or \$2,000 for a family policy. A typical plan will work like this: When individuals enter the medical marketplace, they will spend first from their HSA. [See Figure II.] If they exhaust their HSA funds before reaching the deductible, they will then pay out-of-pocket. Once they reach their deductible, insurance pays all remaining costs.



Annual HSA deposits cannot exceed the amount of the health insurance deductible, and typically cannot exceed \$2,600 for individuals and \$5,150 for families. However, the account balances can earn interest or be invested in stocks or mutual funds, and they will grow tax free. Thus a young person could accumulate hundreds of thousands of dollars by the time he or she retires.

HSA balances belong to the individual account holders and remain theirs if they switch jobs, become unemployed or retire. The funds can be used to pay expenses not covered by insurance,

insurance premiums while unemployed and health expenses during retirement. In the event of death, HSAs may be bequeathed to a spouse, or (like an IRA) the funds may flow to other heirs.

**Conclusion.** The concept of HSAs is not conservative or liberal. It's an empowerment idea. It should appeal to liberals who want an alternative to HMO rationing. It should appeal to conservatives who want an alternative to government rationing. It should appeal to everyone who suspects that impersonal bureaucracies care less about us than we care about ourselves.

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