

HSAs Are A-OK

By ANDY LAPERRIERE

Posted: January 24, 2005

The Wall Street Journal; Page A19

At the start of President Bush's second term, it's clear that he wants to take on the ever-increasing costs of health care. How does he plan to do this? By scaling back the third-party payment system and giving patients a stake in controlling costs. As part of his Ownership Society, he has proposed a tax credit for the uninsured to expand access, but his primary emphasis is on lowering health-care costs through health savings accounts, or HSAs.

HSAs offer a market-based approach to reining in health-care costs, which are growing at unsustainable rates. Under this consumer-driven model, the person who receives the health care will generally be the one who pays for it, which allows the consumer to make the judgments on how to hold down costs and economize scarce health-care resources. The alternative approach -- taking baby steps toward a government-run system -- would mean more bureaucracy and eventually price controls, government rationing, little consumer choice, and lower quality care.

What most Americans don't realize is that HSAs were included in the 2003 Medicare prescription drug law. They became effective in January 2004 and could revolutionize the delivery of health care in America and help put the brakes on rising health-care costs. Tens of thousands of individuals have purchased HSA plans in the few months they have been available, President Bush has made sure they'll be an option for federal employees this year, and surveys of employers suggest that many small and large employers will offer them to their employees in the next year or two. They are also being studied by investors, many of whom are betting HSAs will have far-reaching consequences.

Here's how health savings accounts work: If a person has a health insurance plan with a high deductible (a minimum of \$1,000 for an individual or \$2,000 for a family), he is eligible to put an amount equal to the deductible into a tax-free account. The contributions aren't taxed and withdrawals for health care expenses aren't taxed either. Most importantly, the money in an HSA belongs to the individual and if it isn't spent it is treated like an IRA that grows tax-free and is portable from one job to the next. Employers can offer HSA plans to their employees or individuals can purchase them on their own.

There are two wasteful features of the current health-care system that HSAs will help remedy: 1) high administrative costs, and 2) lack of consumer incentives to use health care economically. Both of these problems are a natural byproduct of the tax code, which, before HSAs, taxed health care paid for by consumers but not that paid for by employers. The result has been a third-party payment system

under which the person receiving the care generally pays only a small share of the bill.

The first problem with this structure is the high administrative costs associated with having insurance companies scrutinize and reimburse routine expenses. Doctors who want to avoid insurance industry red tape pay, on average, 8% of revenue to outsource this function to a billing company. Even if insurance companies spend only a quarter of the amount doctors do on their reimbursement bureaucracies, more than 10% of the cost of a visit to the doctor - \$40 billion per year -- is wasted on paperwork. Most of these costs would disappear if patients paid for their doctor visits directly (with a debit card, for example), which would be the case for most consumers who choose high-deductible plans with a health savings account.

Even more importantly, HSAs will save money by making the patient a consumer. Health care is the only sector in the economy where there is almost no price transparency or consumer price competition. Most patients have no idea how much medical procedures, tests, doctor visits or even prescription drugs actually cost. What's more, in most cases workers who are covered by employer plans only pay their usually small co-pay, so they have little incentive to hold down costs.

HSAs present patients with a completely different set of incentives. If a consumer has, say, a \$3,000 deductible and can keep what he doesn't spend, he will shop around for a less expensive pharmacy, move more quickly to generic or lower priced brand-name drugs, question whether lab tests are necessary and avoid costly emergency room visits for relatively minor ailments. In short, wherever possible, the consumer will demand to know how much things cost, look for the best value, and avoid unnecessary expenses.

Critics say this is a free-market fantasy. They say HSAs will benefit the healthy and the wealthy without reducing costs, and may even increase the number of the uninsured. The early evidence doesn't support the critics. eHealthInsurance reports that a third of HSA policies sold through its Web site have been to the previously uninsured, so they seem to be reducing the number of the uninsured. There's also ample evidence (not to mention common sense) that suggests HSAs will help control health-care costs. Aetna recently initiated a consumer-driven health plan called HealthFund with incentives similar to HSAs and found that in 2003 costs in the consumer-driven plan went up 3.7% compared to a 16.2% increase for a similar patient population in traditional insurance plans.

Patients in Aetna's HealthFund used the emergency room less, switched more quickly to generic drugs, and took greater ownership of their own health care by researching prices and medical information using Aetna's Web-based resources. The bottom line is this: The biggest beneficiary of consumer-driven health care will be the patient. Not only will consumers benefit from lower health-care costs,

but HSAs will inevitably shift decision-making away from employers and insurance companies to patients, who will have more control over one of the most important aspects of their lives -- their own health care.

Mr. Laperriere is a managing director of the ISI Group's policy research team in Washington.

This article first appeared in *The Wall Street Journal*; Section A - page 19, on January 24, 2005. Reprinted with permission.