Health Savings Accounts Scrutinized, Praised

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As President Bush puts health savings accounts higher on his agenda, experts continue to debate whether they are a good idea for solving the problems of the uninsured.

"The more I think about these proposals, the more troubling I find them to be," Leonard Burman, codirector of the Urban-Brookings Tax Policy Center, said in a teleconference sponsored by the Center on Budget and Policy Priorities (CBPP). "I don't think the idea [that people will be more cost conscious] is really going to play out."

HSAs are accounts to which employees contribute to pay for the first several thousand dollars of their health care costs. The accounts are almost always combined with a high-deductible health insurance plan. Contributions to the HSA are tax free, as is money withdrawn for covered medical expenses. If the money is not used in a particular year, it can accumulate in the account.

The Galen Institute, a group that supports consumer-driven health care, has a more positive view of HSAs. "HSAs give consumers even more control over their health spending decisions—and provide them an incentive to spend wisely and save for future health care needs," according to a statement from Galen. Critics argue that sick people are not always in a position to shop around for care; that making consumers more cost conscious won't help lower health care costs, because most health care spending is for expenses higher than the amount of the deductible, which is out of consumer control; and that HSAs tend to attract mostly healthy people, driving up premiums for sicker individuals who remain in more traditional plans.

President Bush highlighted HSAs in his State of the Union address, vowing to "strengthen health savings accounts—making sure individuals and small business employees can buy insurance with the same advantages that people working for big businesses now get."

In a more detailed statement, White House officials said that the president "proposes making premiums for HSA-compatible insurance policies deductible from income taxes when [these policies are] purchased by individuals outside of work. In addition, an income tax credit would offset payroll taxes paid on premiums paid for their HSA policies."

The president is also proposing to allow any spending on out-of-pocket health expenses incurred by HSA enrollees—up to $10,500 per family—to be tax free, not just expenses pertaining to the deductible, as allowed under current law.

Such changes would make HSAs even more tempting to some people, said Jason Furman, senior fellow at the CBPP. "HSAs are already an unprecedentedly favored tax vehicle. This proposal now takes a system already tilted and adds a new tax credit."

If enacted, these proposals could make HSAs so attractive financially that they could begin to rival 401(k) plans as retirement savings vehicles, Mr. Furman said.

For example, suppose a family in a 25% tax bracket contributed the maximum $10,500 to an HSA that is invested at a 3% interest rate. Under the Bush proposal, they would owe a payroll tax of $1,607 but would also get a tax credit for that amount, so the entire $10,500 would stay in the account. If they put the same amount into a 401(k), they would still owe the payroll tax, but would not get a tax credit, so only $8,893 would be deposited into the 401(k) account. Thus the HSA would have $25,486 in it by 2036, versus $21,587 for the 401(k), Mr. Furman said.

With such results, "a lot of employers who offer 401(k) plans would have a lot less of an incentive to," he added. "Their employees could go on their own and get a much better deal from an HSA than from a 401(k), and avoid nondiscrimination rules." The payroll taxes that HSA account holders no longer have to pay would also put a dent in the federal budget, he said.

Barry Barnett, a principal in PriceWaterhouseCoopers' human resource solutions practice, acknowledged that the proposal would result in substantial tax incentives but said he did not think employers were going to get rid of their 401(k) offerings because of it.

Ever since employers have switched to defined contribution retirement plans, "there has been enough noise in the system by employees feeling they've lost the entitlement to a defined benefit plan in retirement," Mr. Barnett said. ■