THE BENEFITS OF HEALTH SAVINGS ACCOUNTS

HEARING

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SUBCOMMITTEE ON WORKFORCE, EMPOWERMENT & GOVERNMENT PROGRAMS

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CONTENTS

WITNESSES

	Page
Crane, Hon. Philip M., U.S. House of Representatives (IL-8)	4
Braden, Ms. Victoria, Braden Benefit Strategies	9
Sullivan, Ms. Kate, U.S. Chamber of Commerce	11
Alders, Mr. David, Carizo Creek Corp.	13
Perrin, Mr. Dan, HSA Coalition	15
Blumberg, Ms. Linda, The Urban Institute	17

APPENDIX

Opening statements:	
Akin, Hon. W. Todd	32
Prepared statements:	
Crane, Hon. Philip M., U.S. House of Representatives (IL-8)	35
Braden, Ms. Victoria, Braden Benefit Strategies	39
Sullivan, Ms. Kate, U.S. Chamber of Commerce	45
Alders, Mr. David, Carizo Creek Corp.	54
Perrin, Mr. Dan, HSA Coalition	59
Blumberg, Ms. Linda, The Urban Institute	75

THE BENEFITS OF HEALTH SAVINGS ACCOUNTS

THURSDAY, MARCH 18, 2004,

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON WORKFORCE, EMPOWERMENT AND GOVERNMENT PROGRAMS
COMMITTEE ON SMALL BUSINESS
Washington, D.C.

The Subcommittee met, pursuant to call, at 10:39 a.m. in Room 311, Cannon House Office Building, Hon. Todd Akin [chairman of the Subcommittee] presiding.

Present: Representatives Akin, Udall, Case

Chairman AKIN. The hearing will come to order, please. We have ourselves a brand new redecorated room, but we do not have a gavel up here so we will just have to have an unofficial gavel.

As I believe most of you are aware, we are here to talk about medical savings accounts and I have an opening statement and I believe that Congressman Udall will have also an opening statement and then we will proceed to our witnesses.

Good morning. I would like to extend a warm welcome to those of you who have taken time out of your busy schedules to testify before the Committee today.

Approximately six of every ten uninsured Americans are in families headed by workers who are either self-employed or work at firms with fewer than 100 employees. It is often the case that the overall cost of health insurance is the greatest barrier to small business in providing such coverage to their employees.

In fact, annual premium increases of 40 to 50 percent are typical of what small businesses and their employees throughout the nation are experiencing today.

In January, the President noted that the best way to help these families is in his words, to let them save and spend their health care dollars as they see fit. He argued that the federal government must empower people to make the right decisions with their health care dollars.

Give them control of a routine cost so that people see the doctor when they need to, spend their dollars wisely and will be able to have coverage for major medical bills. Health savings accounts or HSA's do just that.

Last fall, with the enactment of the Medicare law HSA's became available to an estimated 250 million non elderly Americans. Martin Feldstein, a Professor of Economics at Harvard University and former Chairman of the Council of Economic Advisors under Presi-

dent Reagan argues that HSA's may well be the most important legislation of 2003.

Under the HSA provisions, consumers can make pretax contributions into an HSA account, up to the amount of their deductibles. The HSA earns interest tax free and unused funds can be rolled over from year-to-year.

As long as the account is used for qualified medical expenses, it can be withdrawn tax free. Pretax contributions can be made by the individual employer or family member.

Individuals between 55 to 65 can make up pretax catch-up contributions, which they can use for non-covered Medicare expenses, such as their Medicare premiums.

In addition, HSA's are portable, because the individual owns the account and he may take it with him to another job. Upon death, HSA can be transferred to a family member.

The issue before us today is to examine the benefits HSA's provide to small business owners. I would like to thank the small business owners and health care policy experts who have joined us here today.

Before we hear from you, however, our esteemed colleague, Congressman Phil Crane of Illinois, has been kind enough to speak to us about legislation he recently introduced, his Bill H.R. 3901, known as HSA's for The Uninsured Act would allow an individual to deduct 100 percent of their premiums for high deductible plans that are associated with HSA's. Congressman Crane, thank you for joining us.

Before we proceed with the testimony though, I would like to give our ranking member, Congressman Tom Udall of New Mexico, an opportunity to say a few words. Congressman Udall.

[Chairman Akin's statement may be found in the appendix.]

Mr. UDALL. Thank you very much, Chairman Akin. Pleasure to be with you and good to have you here today, Congressman Crane.

One of the greatest concerns I think for our nation's small businesses is access to affordable and quality health care. The small business community is hit hardest by this growing problem.

Many small firms have no health insurance at all. As the Chairman has indicated, it has been estimated that more than 60 percent of the approximately 44 million uninsured in this nation are small business owners, their employees or their families.

As the coverage rate for large employers approaches 90 percent, firms with fewer than 50 employees have coverage rates just shy of 50 percent. The reason: Small firms pay as much as 30 percent more for policies similar to those used in big corporate entities.

While large corporations have an easy time accessing quality, affordable health care, small businesses, the drivers of our economy, are not as fortunate.

Today we are here to discuss some possible solutions for this growing crisis in the small business sector. I want to ensure that any reforms in our health care system do more good than harm.

Everyone benefits when more Americans can obtain quality health care coverage. President Bush as been looking at ways to use the tax code to encourage more people to purchase health insurance.

The problem with many of his proposals, that while they may help a few, the adverse effects on the rest of the market will only exacerbate the problem. We should actually see the number of uninsured and underinsured in this country increase with some of these reforms.

One of the proposals that we will look at today is expanding the tax benefits for health savings accounts or HSA's, as they were created as part of the Medicare bill last year.

These accounts already offer a tremendous tax advantageous for wealthy individuals who can now put thousands of pretax dollars away for medical expenses. President Bush's Fiscal Year 2005 budget calls for increasing the tax advantages of HSA's by allowing individuals to deduct their health insurance premiums.

While this change may provide an additional health care option for a few small businesses, we must look at the bigger picture: The impact on the rest of the health insurance market.

While some argue that HSA's increase the available options for small businesses, these health insurance reforms do not operate in a vacuum. The expansion of HSA's could have the effect of separating groups of employees into healthy and sick insurance pools. This could drive up costs for those in the traditional insurance market and could devastate some small businesses, particularly those with older and less healthy work forces.

The resulting price hikes from this adverse selection may lead employers to stop offering comprehensive coverage or to raise the share of premiums that employees pay, only creating additional barriers to accessing health care.

It is also of concern that those in the higher tax brackets reap the majority of benefits from these proposals and while I agree something needs to be done, we must target those groups particularly low income workers, who are most likely to lack health care coverage.

I believe the tax incentives like small employer tax credits, if used properly, can help reduce the number of uninsured in this country. Many small businesses which currently do not offer health insurance could easily be enticed to start doing so with the proper fiscal tools.

If we continue to take a piecemeal approach to this issue, it will not tackle the underlying problem: The inability of small businesses to afford health care. Congress needs to create a system in which small business owners, their employees and their families do not live in constant fear of just being one illness away from bankruptcy.

After all, small businesses are this nation's main job creator. It is disconcerting to think they are left without health care options and piece of mind, even though they are the backbone of the American economy.

Thank you, Mr. Chairman. I look forward to hearing the testimony of Congressman Crane and our other panelists today.

Chairman AKIN. Thank you, Congressman. Congressman Crane, thank you so much for joining us and for providing a prospective on your own piece of legislation, which originally I thought of when I heard about medical savings accounts, I thought that was part of

it. It seems like you are adding a piece that maybe seemed like it was missing. Would you please proceed?

STATEMENT OF THE HONORABLE PHILIP M. CRANE, U.S. HOUSE OF REPRESENTATIVES (IL-8)

Mr. CRANE. Thank you very much, Mr. Chairman. Also, Tom, I served with your distinguished uncle and it was a privilege. Mo was your uncle, right or is your uncle?

Mr. UDALL. Yes, he is my uncle.

Mr. CRANE. Yes, indeed. I had the honor of serving with him.

I appreciate the opportunity to be here today to discuss my new legislation to help uninsured small business employees and owners. Just this month alone over 30 members of Congress joined me in introducing H.R. 3901, The HSA's for the Uninsured Act of 2004, which I believe will benefit millions of Americans who are struggling with the high cost of health insurance.

Under current law, health savings account must be purchased in conjunction with a qualified high deductible health plan. Our new bill, The HSA's for the Uninsured Act, allows an individual to deduct 100 percent of the premium of his or her high deductible health insurance, if bought in conjunction with a new health savings account. It is an above-the-line deduction for people who do not have health coverage through their employer.

H.R. 3901 will promote the use of health savings accounts throughout the country and is one of President Bush's top priorities. The premise for this bill is simple: By reducing the cost of health insurance for individuals, more people will be able to afford it.

Before I describe to you the benefits of my new bill, I first want to talk a little bit about HSA's. Health savings accounts work like an IRA. A person can contribute to a health savings account on a tax free basis. The account grows tax free and funds in the account can be withdrawn tax free for medical expenses.

Many of you are familiar with medical savings accounts, the predecessor of the health savings account, which began as a limited demonstration project in 1996. HSA's are a significant improvement over the old medical savings accounts, because they are available to absolutely everyone that wants one.

Medical savings accounts had a number of restrictions that prevented their use from becoming more widespread. MSA's were very successful at making health insurance more affordable for selected individuals.

According to the last report of the U.S. Treasury, 73 percent of all MSA buyers were previously uninsured and at the end of 2003, MSA policyholders saved about $150 million in their accounts.

M.S.A.'s provided the majority of its policyholders with health coverage they couldn't find anywhere else and savings to spend on future medical expenses.

Because the medical savings account program was scheduled to sunset in December, 2003, Congress acted last year to create the next generation of MSA plans. On December 8, 2003, legislation creating health savings accounts was signed into law by President Bush and people have already begun to purchase health savings accounts.

The basic idea behind these accounts is to let people put their own money away for their future health care needs. HSA's are completely portable and can be used for any health care expense, such as prescription drugs or doctor visits.

Under current law, a health savings account must be purchased in conjunction with a qualified high deductible health plan. High deductible health plans are considerably less expensive than traditional health insurance.

The premise behind this requirement is for individuals to use their health savings accounts for their small medical bills, like routine doctor visits. The high deductible health insurance is used for big medical bills, like hospital stays.

Because people get to keep what they don't spend from their account, they will have an incentive to ask for the price before care and check their bill after care to make sure they haven't been overcharged.

Let me explain to you why HSA's are so important for all Americans. Most insured Americans will see an estimated 13 percent increase in their health insurance premiums. This increase follows several consecutive years of double digit increases.

These rising costs are driving people out of the health insurance market. Currently there are more than 43 million Americans without any health insurance at all. One piece of legislation isn't going to solve this problem.

There isn't a simple answer, but there is a necessity to take multiple steps now. One of the most important steps Congress can take right now to make health coverage more affordable is to make health savings accounts more accessible and that is what my legislation does.

H.R. 3901 is the first step toward tax fairness in our health insurance system. All members in Congress, all of our staff and probably most of the people watching this hearing get their health insurance tax free.

Currently, health insurance is tax free to the employer and tax free to the employee. Tax free benefits for health insurance date back to the 1940's and 1950's. In 1943, the IRS ruled that employer provided health insurance was tax free and in 1954, Congress codified that ruling. That has enabled hundreds of millions of families to have health coverage over the years.

As we all know, the economy changes and as a result, the way in which people buy health insurance changes. For the most part, Congress has kept up with this trend.

A few years ago, Congress gave self-employed individuals full deductibility of their health insurance premiums, but our tax policy still leaves the individual purchaser out of the system.

Many of us in Congress have constituents who work for small employers who can't provide health insurance, because of the high cost. Our constituents may be waitresses in diners, workers in a dry cleaning store, widows who go back to work as temporary workers or seasonal workers in the service sector.

None of these workers are eligible for tax breaks for health insurance. It is unfair that some people get tax breaks and some don't, all dependent on whether their employer can offer health insurance, yet it has been our tax policy for 60 years.

The HSA's for The Uninsured Act takes the first step towards providing fairness in our health insurance system by giving a tax break to individuals who purchase health insurance on their own.

In a perfect world with an unending supply of revenue, I would like individuals who buy any type of policy to get it tax free, but with limited revenue, I believe we must start somewhere. We have to target the population who needs help the most, uninsured working Americans who have to buy their own health coverage.

My legislation, The HSA's for The Uninsured Act, does just that, while also fostering savings for the future. Thank you and I now would be happy to try and respond to any questions you might have.

[Representative Crane's statement may be found in the appendix.]

Chairman AKIN. I really appreciate your stopping as I said and talking to us about your legislation. First of all, I think the minority member mentioned his concern with the people who are on the lower end of the economic spectrum and their accessibility to health care. I think you are addressing his question to some degree, aren't you, by making it tax deductible for people to purchase their own?

Mr. CRANE. Right.

Chairman AKIN. It is what we used to call a major medical policy or something like that, is that correct?

Mr. CRANE. Yes, indeed.

Chairman AKIN. You said though that in some way it is limited, because we couldn't afford to do it for literally everybody. I don't understand.

Mr. CRANE. It is limited in that it is catastrophic coverage.

Chairman AKIN. Okay. Only in that?

Mr. CRANE. Right.

Chairman AKIN. Currently——

Mr. CRANE [CONTINUING]And that is because of the premium cost. If you go beyond that and the administration has estimated the cost I think at 24.7 billion over ten years.

Chairman AKIN. One of the things that is always helpful for me in legislation is do sort of a before and after scenario. The before scenario, let us say that I am a waiter at a little restaurant, Joe's Truck Stop or whatever it is. It is a part-time job and they are not offering me health insurance at that establishment.

The way it is right now, the only thing that I can do is just go out in the private market and buy a major medical policy, is that right?

Mr. CRANE. Right.

Chairman AKIN. If I do that, there is no tax break on that at all, is that correct?

Mr. CRANE. No.

Chairman AKIN. Currently, as a member of Congress, my medical insurance is provided as part of my job and that is a pretax benefit, isn't it?

Mr. CRANE. By your employer.

Chairman AKIN. Or by the employer, right?

Mr. CRANE. Yes.

Chairman AKIN. Or if I work for General Motors, General Motors pays for an employee and that is all pretax dollars, right?

Mr. CRANE. Right.

Chairman AKIN. So basically we have set up a system where the people working for the big guys get a pretax or there is no tax on their medical, whereas the guy at Joe's Truck Stop doesn't have that benefit, is that right?

Mr. CRANE. Yes.

Chairman AKIN. Does your legislation create a more level playing field by allowing the guy at Joe's Truck Stop also to deduct his policy?

Mr. CRANE. To deduct his policy?

Chairman AKIN. To deduct the cost of the policy so that it is pretax dollars.

Mr. CRANE. Yes, right.

Chairman AKIN. Basically what you are doing is something that is a matter of justice, isn't it? People are being equal before the law in a sense.

Mr. CRANE. It is expanding the opportunity for coverage to many millions literally of folks out there———.

Chairman AKIN. And the people who are most likely to be uninsured are going to be the people who are in that type of category, aren't they?

Mr. CRANE. Exactly.

Chairman AKIN. What you are doing is really a very important building block to add to or to supplement or compliment the medical savings accounts that we have already enacted into law.

Mr. CRANE. Yes, indeed. It is something that is not Republican, not Democrat. It is something I think in the interests of all of us to try and make that outreach to help those who are in lower income brackets especially and have no coverage and are at that kind of risk to give them an incentive to get into a health savings account and to then take out their deductible insurance coverage.

Chairman AKIN. Is there any problem with insurance companies offering this kind of insurance? I remember before some of the insurance companies said, but it is hard to buy that kind of major medical policy anymore. Will that be available do you believe?

Mr. CRANE. I am sure. I think it is available right now.

Chairman AKIN. Okay. I had heard that the availability was a little bit spotty, but I don't know if that was more of an excuse or whether that was true or not. As far as you know, that type of coverage would still be available?

Mr. CRANE. This kind of legislation would greatly expand that opportunity out there.

Chairman AKIN. If I were sort of the typical 25-year-old working at Joe's Truck Stop, I am pretty much invulnerable. I haven't been to a doctor in ten years and I won't get sick and I won't get old and so I might not have a lot of incentive to get a medical policy, but if I can get one without having to use pretax dollars to buy it, there is at least some economic incentive to do that, right?

Mr. CRANE. There is also an economic incentive to take that health savings account out, because that money accumulates tax free and you can roll it over from year-to-year and build up that account.

Chairman AKIN. Joe's Truck Stop doesn't have a whole lot of extra money they are making, but it is a good guy that runs it. If he wanted to help a little bit, could he then partner with the employee and also purchase insurance or something like that?

Mr. CRANE. I am not sure what you mean by partner.

Chairman AKIN. Let us say that——

Mr. CRANE. He can———.

Chairman AKIN [CONTINUING]The major medical policy is going to cost me $2,000 for the year and I work for Joe's Truck Stop. Could the boss pay 1,000 and I pay 1,000 toward that? Is that something that would work?

Mr. CRANE. If he gives it to you. I think he has to give it to you as an individual, doesn't he? To the individual.

Chairman AKIN. Okay. So they could give me 1,000 and say, this would be 1,000 toward buying some insurance.

Mr. CRANE. Yes, right.

Chairman AKIN. You put a 1,000 of your own in or something like that.

Mr. CRANE. Yes.

Chairman AKIN. It allows a lot of flexibility then?

Mr. CRANE. Yes.

Chairman AKIN. Thank you very much, Congressman.

Mr. CRANE. Thank you.

Chairman AKIN. I think you answered my questions. No additional questions.

Mr. CRANE. All right. Thank you very much and I trust I can look forward to getting you both as co-sponsors ASAP.

Chairman AKIN. I bet you I am already a co-sponsor.

Mr. CRANE. That is right. You are. Thank you. Well, I need you, Tom, on board.

Chairman AKIN. Thank you very much. You said that your schedule doesn't permit you to join us on the panel?

Mr. CRANE. No, unfortunately.

Chairman AKIN. I just wanted to extend the invitation. Thank you.

I think we will now go ahead to proceed to our panel two. If the panel two witnesses would come forward. I think we will get some name tags up there for you and we will get started. [Whereupon, a short recess was taken.]

Chairman AKIN. Welcome to everybody here on our second panel. I see looking down the list that a couple of you have traveled from some distance so we are very thankful for your taking time out of your schedules.

I know everybody has busy schedules and I think that is the case of Victoria Braden. It looks like you are hailing from Georgia, if I am not mistaken and you have your own small business, as I understand and also connected with women owned businesses.

I think what we will do in terms of procedurally, we are going to let each of you make a five-minute statement. I think you have probably been briefed on that ahead of time.

Then after you have made your statements, we will have a chance to interact and ask some questions. If you would proceed, Victoria, please.

STATEMENT OF VICTORIA BRADEN, BRADEN BENEFITS STRATEGIES

Ms. BRADEN. Mr. Chairman, members of the Subcommittee, I am Victoria Braden, President of Braden Benefit Strategies located in Norcross, Georgia.

My company specializes in designing and implementing employee benefit plans for small businesses. I am pleased to appear before you as a member of Women Impacting Public Policy, a national bipartisan public policy organization representing 500,000 women in business.

The subject of today's hearing, the benefits of health savings accounts, is one I am passionate about. I deal with the issue of employee benefits health insurance all day, every day.

As this Subcommittee knows, health benefits to employees, particularly in small companies, is one that is vital to the future of this nation's economic growth. Women Impacting Public Policy commissioned a bipartisan poll of women business owners nationwide in December.

Only one in five businesses offer fully paid health insurance coverage. When asked why they do not provide coverage, the majority said it was too expensive to offer.

Women business owners were asked what would cause them to close their businesses in the next five years. The number one reason, rising cost, was further defined as health insurance costs.

Here is what one of my customers, David Carr, CFO of W.H. Bass and Company had to say about offering health insurance. ''Every year, just after we renew our health insurance and then sporadically throughout the year, I find myself thinking, what are we going to do next year? We continue to tweak the benefits to keep the cost affordable, but at what point are we no longer going to be able to make adjustments and then find our health insurance unaffordable either to the company or to the employees or both?''

David's remarks articulate the struggle that many small businesses face with regard to health insurance coverage. One of the bright lights in this rather dismal picture I believe is the establishment of health savings accounts. It builds on a fundamental principle that employees should share in making decisions about their health care, as opposed to relying on their employers and insurance companies to make those decisions for them.

I would like to offer two examples of how health savings accounts will assist my clients in providing better health care coverage and reduced insurance rates.

My first example is Rhodes Young Black and Duncan, a CPA firm with 14 employees. The firm pays 99 percent of the employee cost of the health insurance the employees pay 100 percent of the dependent cost. Braden Benefits has worked with this business since 2000, when the cost for the employee health insurance was $202 and the cost to the family insurance was $421.

In 2004, Rhodes Young Black and Duncan health insurance plan offered $30 office visit co-pays versus a $10 office visit co-pay in 2000 and a $1,500 deductible instead of a $500 deductible.

In addition, in-network and out-of-network costs have shifted dramatically to the employee. The cost of the current plan is $283

per employee and $842 per family. For the employer, the cost per employee has risen 40 percent and the cost per family has doubled.

At the renewal, we determined that eliminating the doctor office co-pay all together and placing all doctor office charges toward the deductible would save between 12 and 24 percent in premium.

With these savings, the company plans to fund the health savings account for each employee. The employees will have less exposure than they currently have, because that $1,500 deductible must be paid as an out-of-pocket expense.

With the health savings option, the plans will be available to their account, which is tax free and allows them to roll over the money they do not spend year-to-year.

My second example is Johnson Wholesale Floor, an Atlanta based company with 112 employees, 75 percent of which are blue collar work force.

The company has been in business for 40 years, is a solid stable company, with branch offices in Florida, Tennessee and Alabama.

The situation at this company is that their insurance carrier year-after-year pays out more in medical claims than they take in in premium. Every year the company receives a maximum amount of premium increase. Consequently, the company now has a $1,500 deductible.

As benefit providers, we anxiously await the availability of health savings accounts for Johnson Wholesale Floor, knowing that a HSA will prepare the employees for the expense should he or she need to use the $1,500 deductible. Currently it is a completely out-of-packet, after tax expense to the employee.

As costs are increasingly shifted from employer to employee, the availability of a health savings account will help employees make wise health care choices by allowing them to choose to spend their health care dollars.

More importantly, HSA products protect employees that do not currently have availability to pay a deductible, should the employer participate in funding the account.

H.S.A.'s are a wise tool for employers to use for the following reasons: First, the majority of employers that we work with are concerned when the increase costs that their employees bear and are looking for alternatives. The HSA provides one of those alternatives.

Second, the HSA allows employees to accumulate health care dollars over a number of years to utilize at times when they need the health care dollars.

Let me shift to some of the challenges we face in the commercial market at bringing HSA's to our clients. We can't get product. We need clarification from the Treasury Department on several key points that are restraining the carriers from creating and filing products.

What is and is not considered preventative? Can wellness visits have a co-pay? Are prescriptions considered wellness? Can prescriptions have a co-pay and be within the confines of the law? Until we have clarification, carriers cannot develop product. Therefore, we do not have anything to offer companies, at least from the A carriers.

Can flexible spending accounts be used with an HSA? If an employee elects an HSA for their employee health coverage, do they forfeit their participation in the flexible spending account? If the employee cannot participate in both funds, what effect does this have on the discrimination testing?

Answers to these questions will expedite the offering of the health savings products, a very positive addition to the health insurance benefit offerings.

In closing, let me just say that the responsible employers do not want to eliminate the doctor visit co-pays, eliminate prescription co-pays and leave the employee and their family without a means to afford health insurance.

They want to provide health insurance to their employees. At the same time, they struggle to get health insurance costs under control.

I believe HSA's used proactively to promote options to businesses and their employees gives both the employers and the employees new options which will have a positive effect on small businesses. Thank you, Mr. Chairman.

[Ms. Braden's statement may be found in the appendix.]

Chairman AKIN. Thank you, Victoria. I appreciate your comments.

Our next witness is Kate Sullivan, U.S. Chamber of Commerce and coming from D.C. here.

Ms. SULLIVAN. Yes.

Chairman AKIN. Kate, thank you so much for joining us.

STATEMENT OF KATE SULLIVAN, U.S. CHAMBER OF COMMERCE

Ms. SULLIVAN. Thank you. We are very pleased to be here this morning. The Chamber is the world's largest business federation, representing over three million employers of all sizes and all sectors all around the country, around the world.

President Bush spoke this week at the Chamber about what HSA's have done for small businesses and we had several small business owners there explaining how this has helped them save money and to do more for their employees.

As an aside, he also spoke about association health plans and the need to get this enacted by the Senate this year.

We have advocated for a number of years that all Americans have health coverage through an appropriate mix of market reforms, public financing and a meaningful safety net.

Everyone in this country, whether privately covered, publicly subsidized or uninsured also has the right to expect that our health system has at its root the best possible quality with uncompromising standards of safety.

An ideal health system involves many elements that must work together, such as private sector choices, effective us of the tax code and greater use of information.

Enacting last year of health savings accounts came at a critical time for America's employers and working families. There is much they offer, not only for small business, but for workers at any point in their lives, particularly those times when they are not working.

Healthy market competition will help lower health care costs and improve our health system. The insurance market, particularly for small businesses, has largely stagnated over the last five years.

We have found that this lack of competition stems from state mandates on health plans, which have taken away health plan's ability to differentiate themselves in the marketplace and compete for customers by offering benefits tailored to meet their needs.

Health savings accounts hold the promise of reviving the largely abundant, but costly small business insurance market. While a number of larger employers have experimented with so-called consumer driven health plans, made possible by health reimbursement arrangements, non-discrimination compensation testing has largely prohibited the availability of this plan design for small businesses and partnership arrangements.

H.S.A.'s offer a number of advantages for employees. First, the account is held exclusively by the taxpayer, rather than the employer. Employers may contribute to the HSA, to the account itself, as well as to the insurance premiums, which ease concerns for younger or less affluent workers about funding their deductibles.

As with other compensation requirements, employer contributions must be made fairly across the employee base and HIPAA compliance with require that contributions not vary based on an employee's health status.

Many small businesses were already forced to adopt higher deductible health plans as insurance costs nearly doubled over the last five years and insurers specializing in these kinds of health plans have entered stated, will now come into states where they have once done business, but left, because of the over regulation in some of those markets.

We will also see traditional insurers also offer HSA products in an effort to hang on to their small business customers.

This is great news for small business owners, because they really do desperately need that competition for their many substantial dollars that they are spending this way.

They also offer a pretax mechanism for those who are paying for insurance when the account holder does not have work place coverage. This is the first time the tax code has operated in this way.

Premiums must be paid from HSA balances, though annual contributions are still restricted to the amount of the annual deductible.

Greater tax code changes must be made. President Bush and Congressman Crane, as we just heard, have put forth important proposals toward this goal and we support that legislation.

Providing tax code parity for the millions of taxpayers who acquire their own coverage in the individual market has been a longtime priority of ours and it will continue to be a greater need for more Americans.

More retirees do not have access to that coverage and we have people in their 20's who are not working because they are pursuing higher education later in life.

We need to make this tax code parity greater across the board and we shouldn't restrict ourselves just to premium deductions for HSA's. We need to do more for low income individuals through

vouchers or tax credits, to help those who do not pay taxes, but still need to pay premiums on their own.

My full statement goes through some of the other issues in the tax code that can help benefit both health savings accounts and other forms of health coverage and that is available in the back of the room.

In summary, we also recognize there is a much greater need for information about our health system, the best quality doctors and the prices that providers pay.

Large employers have been working very hard to make that information available and the Medicare law enacted last year will provide additional incentives to hospitals to disclose more information about how they treat patients.

Critics of market place health care solutions are working hard to convince policymakers that the widespread use of HSA's and health insurance tax incentives that are aimed at individuals will undermine the employer based health system.

In fact, the real thing that is going to undermine the system is cost in this system. We need to do better, in terms of bringing down that cost and empowering individuals to take control of their health care dollar.

No longer can employers allow the money to go into health insurance premiums that should go in to paychecks and we need to get that money returned to individuals, both for their health care dollars and for all the other consumer needs that they have. I look forward to discussing this with you more and questions and answers.

[Ms. Sullivan's statement may be found in the appendix.]

Chairman AKIN. Thank you very much for your testimony, Kate.

Our next witness is David Alders, coming all the way from Texas. I understand, David, that you are a small business owner yourself.

Mr. ALDERS. That is correct.

Chairman AKIN. If you would proceed, thank you.

STATEMENT OF DAVID ALDERS, CARIZO CREEK CORP.

Mr. ALDERS. Thank you. Mr. Chairman and members of the Subcommittee, it is a distinct privilege to be with you today to testify on one of the critically important issues facing almost every American family, including my own: That of access to quality, affordable health care.

My name is David Alders and I am the owner of a small diversified agribusiness enterprise in Nacogdoches, Texas.

I am here today also representing the National Association for the Self-Employed and its 250,000 member businesses, representing well over a half million individuals across America.

The NASE represents the smallest of America's small businesses, those which often are in the process of being bootstrapped by owners whose vision and ambition outstrip their capital or credit, but who enthusiastically incubate the American dream and who collectively are a major force for job creation in our economy.

Because our businesses often are so thinly capitalized, ours is a sector which perhaps is most squeezed by America's health care cost crisis.

Census data indicate that of the approximately 43 million Americans without health insurance, 62 percent are from families in which the household head is either self-employed or working for a company with fewer than 100 employees.

The reason this group disproportionately neglects to secure health care coverage is easily understood. On average, workers in firms with fewer than ten employees pay 18 percent more for health coverage than those who work in larger firms and as Representative Udall noted earlier, perhaps that number actually now is significantly higher.

We at the NASE are convinced that America is blessed with the finest health care system in the world and that it is so blessed because of and not in spite of its reliance on market forces.

While we don't believe market mechanisms with eliminate every unfortunate human experience in the delivery of health care, we do believe they will produce better outcomes than those of centralized government mechanisms.

Market based reforms begin with more neutral tax treatment of health insurance purchasing options, insurance options which emphasize protection against major risks and deregulation of health care suppliers.

Instead of more regulation and litigation, such reform underscores the primacy of voluntary contracts and market prices.

In short, the ultimate market based reform is to guarantee that the health care consumer is also the health care billing watchdog. Health savings accounts, coupled with high deductible health insurance plans, work splendidly to accomplish this basic measure of market accountability.

My business has taken this approach for several years, maintaining adequate coverage due chiefly to ever escalating deductible thresholds.

Health savings accounts now offer me the opportunity to set aside pretax dollars to fund care which is relatively minor or merely palliative and gives me the incentive to carefully question whether I need to access the system at all, a question which a meaningless $10 co-pay in a conventional plan will always lead a consumer to answer in the affirmative.

To further enhance the appeal of HSA's, we strongly support the passage of H.R. 3901, which as Representative Crane noted, would allow individuals who purchase high deductible insurance policies and who also fund HSA's to deduct the value of those premiums from their income taxes.

Of course, H.R. 3901 applies only to those taking advantage of HSA's and we believe this disparity in the tax code ought to be remedied and removed, regardless of whether a small business owner funds an HSA.

H.R. 1873, the Self-Employed Health Care Affordability Act, would allow the self-employed to fully deduct their health insurance premiums and thereby achieve parity with corporations, which provide their employees' health care coverage and expense the cost thereof.

Heretofore, the self-employed and small business owners have been discriminated against by having to purchase their health care

coverage with after tax dollars and by in effect having to pay the self-employed payroll taxes on their health insurance premiums.

Starting and expanding a competitive small business is difficult enough without having to pay an additional 15.3 percent on one's insurance premiums.

Our members would greatly appreciate your support of both these important pieces of legislation.

We are not under the illusion that tax code changes and the creation of HSA's alone will constitute a silver bullet, which will solve America's health care cost crisis, but they are a welcome step toward consumer driven health care.

The Galen Institute brought to Capitol Hill last month six of the leading vendors of health reimbursement arrangements, such as MSA's or now HSA's. The experience of these vendors is that people who utilize these vehicles tend to be older and slightly sicker than those who do not, but they also tend to make much better use of preventive services, use generic drugs much more, use hospital ER's much less, access supportive services like nurse hot lines much more and generally have been holding down costs significantly.

In short, the market works when given a chance and people will spend their own money more wisely than they will spend someone else's.

I am grateful to all of you who are working to contain costs, while protecting the quality of our system. Preserving the world's finest health care system is worth the effort and America's employers and employees are counting on your success. Thank you.

[Mr. Alders' statement may be found in the appendix.]

Chairman AKIN. Thank you very much for your comments, David and we will get back with questions in just a minute.

Our next witness is Dan Perrin. I believe you are the Executive Director of the HSA Coalition.

STATEMENT OF DANIEL B. PERRIN, HSA COALITION

Mr. PERRIN. Thank you, Mr. Chairman and thank you Mr. Udall. On behalf of the HSA Coalition, we appreciate this opportunity and ask that my statement appear in the record as if read.

Chairman AKIN. Without objection.

Mr. PERRIN. Thank you. Mr. Chairman, the most consumer friendly type of health care is health care that is affordable and I thought it would be useful to go through an example of how that works with the health savings accounts.

Essentially what you are doing is you are refinancing your health care. You are taking a lot of money that both the employer and the employee spend and you are rearranging the way you spend it. Part of it goes towards a major medical insurance policy, which costs a lot less and then what is left over goes into an account from which you draw down.

What happens is that then creates a behavioral change in the consumer, which is a lot like the difference between going to a restaurant where you are on an expense account versus going to the same restaurant when you are paying yourself. Your choices on the menu vary greatly.

If we move to Exhibit A, basically the average monthly premium, according to Kaiser Family Foundation, in 2003 for the United States was $755 a month, which is $9,068. That is both employer and employee money.

Taking an example for a 40 to 49-year-old out of Florida, in the individual insurance market, that premium is $235 or $34 a month now in Florida, which is a total of $2,800 in rough numbers a year.

If you then take $5,150, which is the amount of that deductible and you put it in a bank account, you have a total expenditure of roughly $8,000. You started with 9,100, which is the average.

Fully funding the health savings account leaves you with an expenditure of $8,000, to be divided up between employer and employee as they see fit. You save a grand, in this example 1,100 and you have effectively given the employee first dollar coverage, because they spend that money to get to their deductible.

The second example in terms of the bigger picture in how this works and what we have been through in the United States with double digit health insurance cost increases, especially over the last five years, is this chart from the Joint Economic Committee, which is Exhibit B of my testimony.

Basically the story that it tells is pretty clear. It essentially says that since 1960, the out-of-pocket percentage of expenditures, in terms of what the actual consumer is spending, has dropped and inversely, the cost per capita of health care has increased. It is a pretty clear picture.

Health savings accounts will do simply this: It will decrease the total cost of health care by increasing the out-of-pocket or in this case the out of your health care savings accounts expenditure by consumers.

Mr. Udall, I just wanted to note that your opening statement talked about the decreasing base of employer provided coverage. The baseline that we are working from today is that we are at 45 percent. We were at 63 percent ten years ago.

At the current rate of decline, we are going to be at 36 percent in five years and that cite from the Labor Department is on point three in Exhibit E.

Finally, Mr. Chairman, I just wanted to go through quickly Exhibit C, which is the build-up of funds potentially under various expense time scenarios for a health savings account.

The reason this is important is because people should be showing up at the doors of Medicare with cash, because we all understand that system is under increasing financial duress and this chart simply goes through some scenarios which may apply to certain people, depending on the amount of their deductible and how much money is deposited in their account a year, but the numbers are significant and it is a very important piece of this.

Finally, let me just add the following: We have seen an explosion of insurance companies coming into this market. There are 30 insurers today offering. They are in every state. There are 12 more who have announced that in the next eight months they are going to be in some very large companies.

Yesterday, for example, Blue Shield of California came into the market and in one case, a trustee who is a businessman who holds the account money for an individual who purchased the insurance

from an insurer, who may not provide that account management service, said their business is doubling every month since January.

When you compare it to the medical savings account start in 1996, this is a dramatic and significant difference. Thank you, Mr. Chairman.

[Mr. Perrin's statement may be found in the appendix.]

Chairman AKIN. Thank you very much for your comments, Dan.

Our last witness is Linda Blumberg, a Ph.D. from The Urban Institute, Washington, D.C.. Linda.

STATEMENT OF LINDA J. BLUMBERG, THE URBAN INSTITUTE

Ms. BLUMBERG. Mr. Chairman, Mr. Udall and members of the Subcommittee, thank you for this opportunity to testify on health savings accounts and H.R. 3901, a proposal to make premiums for the high deductible policies associated with HSA's tax deductible.

Reforms of the health insurance market have important implications for small businesses, which face special challenges in providing health insurance coverage to their workers.

There are three main problems for small businesses: First, small firms face much larger administrative costs per worker than do large employers; second, insurers charge small firms higher risk premiums because of their greater year-to-year variability in medical expenses; third, the average worker in a small firm is paid significantly less than the average worker in a large firm.

While there are mechanisms available for addressing the problems facing small businesses, HSA's and the policy contained in H.R. 3901 are not among them. Instead, they will tend to increase administrative loads, reduce pooling of health care risk for workers in small firms and subsidize high income individuals much more than low income, low wage workers.

The HSA provisions and the Medicare prescription drug legislation provide a generous tax incentive for certain individuals to seek out high deductible policies. Individuals and families buying these policies, either through their employers or independently in the private non-group insurance market can make tax deductible contributions of up to $2,600 per year in a HSA, $5,150 for a family. Money in the account and any earnings are tax free, if used to cover medical costs.

These accounts provide the most advantage to high income people and those with low expected health expenses. The tax subsidy is of little or no value to those who do not owe income tax. Higher income individuals are also better able to cover the cost of a high deductible.

Additionally, those who do not expect to have much in the way of health expenses will be attracted to HSA's by the opportunity to accrue funds tax free that they can use for health care that is not covered by insurance.

They can also be used effectively as an additional IRA, whose funds can be used without penalty after age 65. Young healthy individuals may even choose to use employer contributions to their HSA's for current non-health related expenses, after paying a ten percent penalty and income taxes on the funds, a perk unavailable to those enrolled in traditional comprehensive insurance plans.

H.S.A.'s will not address the high administrative costs of small employers. In fact, administrative loads are actually higher for high deductible policies since the many fixed administrative costs must be charged on the smaller level of benefits paid out and the tax subsidy under H.R. 3901 would also be worth more to those who need less assistance.

More importantly, it would undermine the small employer market by increasing the incentive for individuals to purchase health insurance in the private non-group insurance market as opposed to acquiring it through employers.

Low cost, high income purchasers equipped with yet another subsidy would be likely to find price advantages in the non-group insurance market, since most states allow non-group insurers to charge lower premiums for those in good health and to completely exclude from coverage those with current or past health problems.

But as low cost purchasers leave the group market, the average cost of those staying in the group market will rise, making group insurance more difficult to afford for higher risk and low income individuals.

In addition, since employers and key employees will be able to get tax breaks for their high deductible health insurance, even if it is not provided to other employees, there will be even less incentive for employers to take on the hassle, expense and risk of offering insurance to their workers. The net result could be less insurance coverage among small businesses.

While the risk pooling available to small firms is low, compared to large firms, they are still afforded a greater degree of pooling than is the case in most states' non-group markets.

Administrative costs in the non-group market are also much higher than for small firm purchasers. Consequently, high cost and low income workers will be the big losers, as coverage shifts from the small group to the non-group market.

High administrative costs, limited ability to spread health care risk and lower wages can be addressed in a variety of ways. These include providing mechanisms for small employers to purchase coverage in larger groups, thereby lowering administrative costs; broadly spreading the costs of high risk individuals across as large a segment of the population as possible, using public re-insurance mechanisms or other risk spreading tools; and providing subsidies to low wage, low income workers for the purchase of coverage.

The Treasury Department estimates that allowing deductibility for individually purchased high deductible health insurance would reduce federal revenues by $25 billion over the next ten years, even though the net result could be a reduction in coverage.

Funding approaches designed to address the problems faced by small employers would be federal money better spent. Thank you very much and I would be happy to answer any questions that you might have.

[Ms. Blumberg's statement may be found in the appendix.]

Chairman AKIN. Thank you very much all of you for your testimony and we will proceed now I guess with the questions. Just because of the makeup that we have got, I will defer and let Mr. Udall, if you would like to go first with your questions it would be fine.

Mr. UDALL. Thank you, Mr. Chairman. Let me ask Ms. Sullivan with the Chamber: Would you support a proposal that allows small businesses to buy into the Federal Employee Health Benefits Program to purchase insurance for their employees, a small employer health benefits plan?

Ms. SULLIVAN. There are proposals like that and I think the way it is structured is that you don't actually buy into the actual FEHBP but something administered by OPM that stands side-by-side.

I think federal employees and retirees have some concerns about allowing people who are excluded basically from the current insurance market to get into it.

We have reservations about the proposal that was introduced in the Senate, because it is being administered by OPM, which really does not deal right now with the private market and it comes along with some requirements about cost sharing, how much the employer must contribute to these plans.

We really believe that because health benefits are part of your overall compensation, that you need to really work within the industry and allow them to decide how much you need to pay in wages versus benefits.

Clearly those who advocate such a proposal recognize two fundamental problems with limiting that kind of risk pooling only within a state. You have more small businesses that now operate across state lines. They are doing now what only could be done by very large corporations a few years ago.

I think turning it exclusively over or providing some kind of market preference like that to a federally run plan then really would suck up everything that does allow the private market to work with individual small business owners to offer that proper mix of benefits and compensation.

I would be happy to provide you with more extensive comments about these proposals.

Mr. UDALL. Thank you. Ms. Blumberg, one of the things we always hear about MSA's and HSA's is that the result is adverse selection and separation of risk pools. Would the proposal we are looking at today increase the likelihood of adverse selection and could you describe if that is the case, how would that happen?

Ms. BLUMBERG. I believe that would be the case with H.R. 3901. What the legislation does is creates an additional tax incentive for individuals to purchase their insurance coverage through the individual non-group market, as opposed to the group market.

What we know about insurance markets is that there is a much greater degree of risk pooling, of bringing together individuals of different types of risk for purposes of determining insurance premiums, in group markets, as opposed to the non-group market.

In the majority of states, what we see is regulations that will allow insurers in the non-group market to adjust premiums charged as a function of what an individual's health status is.

In fact, most states also allow insurers to actually exclude very high cost individuals or individuals they perceive as being high risk from coverage completely.

What could happen as a consequence of this legislation, as we give more tax advantages to higher income people who are basi-

cally healthy, to move into the non-group market, what happens is the residual people, the higher risk people, the lower income people who are left in the group market will see their premiums on average increasing as the healthy people are exiting. That is a pretty classic adverse selection dynamic.

Over time, the premiums could escalate substantially in the group markets and these individuals who are left would have a hard time getting a group policy or comprehensive policy after that.

Mr. UDALL. One of the things that you mention in your written testimony on page two is you say only 39 percent of establishments in firms of fewer than ten workers offer health insurance to any of their workers, compared to 99 percent of establishments in firms of 1,000 or more workers.

It seems to me in looking at this that our problem is trying to get health insurance coverage to smaller firms and that that is where we are having this problem with insurance.

Would you comment on that and on those figures that you laid out there and where you see the real problem today in terms of the uninsured and underinsured?

Ms. BLUMBERG. Sure. What you said is true, that there is obviously a much lower rate of insurance coverage being offered among small firms and for very good reasons I would say, because of the high administrative loads that they face compared to bigger firms, because they don't have as much ability to spread risk as larger firms, even though they can spread risk better than is true in the individual market.

Small firms' workers have lower wages on average, than do large firms' workers. Economists believe that individual workers are actually paying for the full premium, because their employers will pay them less cash wages in order to compensate for the cost that they are paying in benefits, as opposed to wages. When you have got a lower wage work force, there is less room to pass those costs back in lower wages.

One could look at it as you did, that the problem is figuring out how to get more coverage in the small employer market and there are mechanisms I believe for doing that, but I think you could also ask whether structurally if the small group market is the place to actually rely upon to increase coverage.

If we decide that the answer is no, that that is not the best place, then what we need to do is create a structure that is conducive to the workers and their dependents who are associated with small firms, to purchase coverage. But the current non-group insurance market is just not efficient, it is not effective, it is not as equitable in terms of the risk pooling that is available, for us to rely upon it for a widespread increase in insurance coverage.

I would say if you are going to move away from looking at small employers as the base, then you need to build something to replace it in the current private non-group market I would say is not it.

Mr. UDALL. Thank you very much and I thank all of the panel for their testimony. Mr. Chairman.

Chairman AKIN. Thank you, Mr. Udall.

Also, we have been joined by my good friend, Congressman Ed Case. Ed, did you want to offer any questions to the witnesses?

Mr. CASE. Thank you, Mr. Chairman. Mr. Alders, I was intrigued by your testimony, because you represent a lot of the businesses in my district and I suspect a lot of smaller rural oriented districts across the country.

My businesses are small mom and pop operations, husband and wife teams, sole proprietorships running small scale agriculture, small scale tourism, T-shirt shops, sole proprietor realtors, et cetera, et cetera. I think that is what you represent.

Mr. ALDERS. Yes, it is.

Mr. CASE. This may be a little bit of a tough question, but can you give me your reaction, from your real world experience, to Dr. Blumberg's testimony? I am asking you to do that, because I take her concerns seriously.

Will in fact health savings accounts or medical savings accounts, more control over individual contribution and spending decisions by businesses, cause adverse selection? Will it increase administrative costs? Does it disproportionately impact higher income people?

The business owners that I know that are in your category are not the high end of the income earners of our country. Just tell me what you thought as you listened to her testimony. What was ringing true and what was not?

Mr. ALDERS. I don't consider my peers in relatively small agricultural operations to be high income either and I think they are the kinds of people who in our country have to face the decision of what they are going to do about health care. Are they going to insure at all and if so, what can they afford to insure against?

I will say that my partner here on the panel, Dan, has probably thought through those arguments to a far greater degree than I have, but from my personal experience, I believe that the closer the health care consumer, regardless of his income level, the closer he is to the health care bill, the more he scrutinizes how much his access of a system is going to cost and the more he has skin in that game, so to speak, the wiser are going to be his choices, his decisions. I don't know. Even incremental steps toward that I think would be very healthy.

Just to give you a personal anecdote, a week ago one of my eight children split his head open on a rock and so I had cosmetic medical work that had to be done. I called a friend in my community, a surgeon and met him at his office and I bypassed the ER system, because of the cost that I knew I would incur there, several hundred dollars in medical expenses versus maybe a hundred or $200 visiting my friend's office after hours and we got Sam's head stitched up appropriately.

Because I have a high deductible policy and because those costs I knew were going to come out of my pocket regardless of what they were, if they were 2,000 they were coming out of my pocket, if they were 200 they were coming out of my pocket, but I went with a lower cost alternative that was even preferable, because I knew the guy who was going to be doing the stitching.

I think if you empower consumers they are going to make smarter choices. We see that in every other realm of American business. I don't know that my employee can afford a $5,000 family deductible policy, like I do. In fact in the past year he has had an ex-

tended hospital stay and he has an $11,000 medical bill that he is paying out just a few dollars every month.

I couldn't afford to purchase health care insurance for him. I do give him a higher salary so that he can make that choice. He can choose what he wants to do. He chooses not to be insured and his children have been covered under the Texas CHIPS program.

That $11,000 bill is a bill he is going to have for many, many years and I would be happy to contribute. Instead of paying him the salary I do, take two or $3,000, a couple thousand dollars a year and fund an HSA. I mean he would have $4,000 there since his beginning of employment with me, if HSA's predated what they did and he would be able to meet some of those medical expenses through that HSA and he could afford that high deductible policy with an HSA.

My personal experience is that I think if a consumer is in charge of paying some portion of that health care bill, he is going to make a much wiser choice.

Mr. CASE. Thank you. Dr. Blumberg, I don't want to leave you out of this. You suggest we are putting our money in the wrong place. I think that is essentially what you are saying. We shouldn't be putting it here. We should be putting it over on the side of the CHIPS and lower income health care coverage.

If we were funding adequately at that level, would you have the same degree of reservations with the deductibility of HSA premium payments?

Ms. BLUMBERG. Yes. Essentially when I look at the problem of the uninsured today, I think there are two main areas in which we need to subsidize further. The first is clearly the low income, and I think most people in the room will agree that we could do a better job with that, but the second key element is that I believe we need to subsidize high risk, as well, as a social decision.

Basically all of the issues that we have when we start doing reforms outside of expanding a public program, such as CHIP or Medicaid, relate to problems of adverse selection and risk segmentation.

When insurers can be much more profitable by bringing in low risk individuals, then we can't blame them for seeking those low risk individuals out. The regulations allow them to do that and the market forces really dictate that they do that, in order to compete in the insurance market.

But what happens is that the individuals who are high risk or high cost or who have even some past kind of health care problem are really very vulnerable in this kind of dynamic. As we go create incentives to move individuals further into the private non-group insurance market, where we see even less risk pooling than we see in small firms and much less risk pooling than we see in the large firm market, then we are making those high risk individuals even more vulnerable than they already are, because they are not well served by the private non-group market.

If we do anything to undermine the group market as it exists, high risk people, high cost people who are currently receiving coverage and receiving some risk pooling benefits from being in those group markets are basically then left out in the cold once they are in the existing non-group market.

I think if we were better subsidizing the low income and the high risk, then I wouldn't have a problem.

Mr. CASE. Thank you. Thanks, Mr. Chairman.

Chairman AKIN. Thank you, Ed, for your comments.

I had a number of different questions here. Let me start off and I think I may toss a couple of these out just to whoever wants to respond.

First of all, just for my own information, do these HSA's in any way do they get around some of the insurance mandates that are dictated by individual states or does the person offering the insurance have to comply with the state mandates?

Ms. BRADEN. Mr. Chairman, it is my understanding that they do have to comply with the state mandates individually and have to be approved by a per state basis.

Chairman AKIN. Okay. That is one thing people complain raise the cost of health care is the various state mandates, but this doesn't really deal with that part of the equation.

Ms. SULLIVAN. We are waiting for clarification from the Treasury Department on a couple of those matters with regard to that preemption and what needs to be covered in these plans, but it comes down to fundamental plan design.

You still have this deductible. If you are required to cover in vitro fertilization or some of the other things that do drive up the cost, it would be subject first to that deductible.

The one thing that has been waived is preventive services and that is where we really get into some dicey concerns, because some states can begin determining a lot of specialty services and begin to consider them as preventive.

We are waiting to see what kind of definition there is and this has implications across the spectrum for all employee benefits, because how employers determine what is within their own plan design and a number of very smart people who work on this have provided those comments to Treasury and we are waiting for that clarification.

Chairman AKIN. So to some degree my question isn't totally out in left field, but in general it is assumed that most of these plans will follow the state regs pretty much.

Under the current situation with HSA's the way the law stands right now, the premiums are currently paid by what? Is it paid by the employee?

Mr. PERRIN. Sir, the premium can be paid by the employee or the employer. Under certain circumstances, i.e. you are unemployed, you are on unemployment insurance, you can take money out of your account to pay that premium or if you are on———.

Chairman AKIN. If you are unemployed, you could take pretax dollars out of your account to pay for your insurance?

Mr. PERRIN. Yes, sir. Let me just give you a little vignette on that. The———.

Chairman AKIN. I have asked this question. I keep getting different answers on it. It must be tricky.

Mr. PERRIN. No. This is a clear case of if you are on unemployment insurance, you can take out of your HSA account tax free and pay the premium. For example, airlines after 9–11 thousands were let go and one of the VP's of one of the major airlines became con-

vinced that HSA's were what they should be providing to their employees for circumstances exactly like this, because she had pregnant women and all kinds of stories. That is the current situation under the current law.

Chairman AKIN. I was kind of surprised that what Congressman Crane was proposing wasn't in the original bill to begin with, because it seemed kind of logical in a way to fit in. Was that just part of the politics of putting it together do you know?

Mr. PERRIN. That basically sums it up, sir.

Chairman AKIN. Go ahead.

Ms. BRADEN. On the group health side, for a group policy, usually the insurance company requires that the employer pay a percent of the employee amount in order to make it part of the group policy.

Chairman AKIN. Right.

Ms. BRADEN. So that is where that comes from.

Chairman AKIN. Thank you. I had a couple of other questions here. Mr. Perrin, I think maybe you could answer this.

Unions represent a fairly significant part of the rank and file throughout the country. In the interest of unions, who benefits from HSA's? Is it only the business owners that benefit or do you union employees benefit as well?

Mr. PERRIN. That is a great question, Mr. Chairman. You may know that the Hotel Employees and Restaurant Employees Union, prior to the vote in the House in August, sent a letter up to select democrats supporting the passage of the health savings account legislation.

There are two primary reasons they are doing this. The first reason is that the union wants to hold the money. They have a bank. They want to hold the money.

The second reason is and most important reason is that it dramatically drops their cost of their health insurance and in some cases, I have spoken with the very senior leadership of some unions where you have a guy who works his whole life in the union and when he reaches 51 or 52, he can't do the manual labor.

He can't work at what he has done. He goes out and he has this gap between when he stops working and gets insurance and when he goes on Medicare.

The leadership of this union was very interested in seeing that money build up for these guys so that they have some cushion in that time in which they are no longer working.

In addition, when you move to a high deductible insurance policy, you are not talking about $755 a month. You are talking about $250, something much more affordable.

For the unions who have been trading wages for benefits for a decade now, this offers them the opportunity of getting a raise and containing their health care costs.

Let me just explain one other example. There is a union in the midwest, a statewide union, they are $10 million a year in the hole. This is what, when they went to their actuaries, they were told: You triple your out-of-pocket deductible, you add another ten percent cash to the plan and you reduce the 80/20 co-pay after you have met your deductible to 70/30.

That is a real life scenario and I would be happy to provide you the person to call to confirm that and that was a year ago.

Unions are getting killed by these costs exactly like everybody else and they are looking for something that is affordable.

Chairman AKIN. Thank you for answering that. Our time isn't too bad today so I am going to allow myself to run over a little bit and if the other gentlemen want an extra question that would be fine.

Now to Linda a couple of questions that I had about what you were saying. I think all of us recognize that if you get somebody who all of a sudden develops diabetes, heart condition and a few other miscellaneous things, they get to the point where nobody wants to insure them, because they call them sort of uninsurable.

It would seem to me that from some of the numbers we have heard, that if only one in five of the small businesses offer insurance to begin with and there are two questions really on the uninsurable thing it seems like to me, the first one is: The major problem that when somebody is uninsurable, who do you do with that?

But aside from that question, it seems like one thing that you could do would be to reduce the number of people who are uninsurable and it would seem like to me just from a common sense point of view if you have Superman at 25 and you manage to get him from the uninsured category, where he is healthy, into the insured category and by the time he is 35 all of a sudden he is diabetic or something, then at least you have the benefit of having gotten people into the insured category.

My understanding is once you are insured then if you become uninsurable, you at least have some ability to continue your policy. Does that make sense or would you respond to that?

Ms. BLUMBERG. Sure. First, in the small group market there is technically no one who is uninsurable. The small group who has a very sick person in it may have to pay substantially more for insurance, depending upon the pool that they are in, but there is guaranteed issue now through HIPAA in the small group market.

In the non-group, the private non-group market———.

Chairman AKIN. I don't mean to interrupt you, but does that also make it so that let us say you are a small business, you have five employees and one of them is in that category, does that also make it a lot more expensive to get the———.

Ms. BLUMBERG. Yes. They can charge you up for that, depending upon how they are setting their premiums and what other firms are in your pool. You will likely experience an increase and the extent of the increase is a function of what state you live in, because the regulations on pricing——

Chairman AKIN. It varies from state-to-state.

Ms. BLUMBERG [CONTINUING]In the small group market vary from state-to-state.

Chairman AKIN. It is going to cost you more for everybody——

Ms. BLUMBERG. That is right.

Chairman AKIN [CONTINUING]When you have someone in your pool that is uninsurable.

Ms. BLUMBERG. That is exactly true. In the private non-group insurance market, there is no guaranteed issue in the vast majority of states and so individuals can be completely excluded. Many

states also allow you to write out particular body parts or body systems that you have either had problems with in the past or have current problems or maybe a dependent does.

There is guaranteed renewability, but again think about what the effective truth is when you have somebody who is very high cost in a narrowly priced pool in the non-group market and their premiums go up substantially over a course of a year or two.

Then even though the law says that they are guaranteed renewable, they don't necessarily have effective access to that insurance over time.

Even if they buy into the non-group market when they are young and healthy, there is no guarantee that they are going to be able to afford to stay in it, because of the way that the pricing works in most states.

In addition, sometimes a———.

Chairman AKIN. Let me clarify that. So in other words, let us say I am 25 and Superman. I get the insurance.

Ms. BLUMBERG. You are talking about in the non-group market?

Chairman AKIN. Non-group. This is just like an individual major medical policy. Me and my wife, a couple of kids or something and we run along five, ten years. We pay for the high deductible stuff. We are covering the other stuff out-of-pocket the way we have been talking about.

Then all of a sudden either one of my children, my wife or myself we get something that makes us more uninsurable, I think of diabetes because it is one of those things that you can get an onset somewhere along the line, you don't know it is coming.

The way most of the insurance works, you still can continue to buy insurance, can't you, in the next year after you have gotten the diabetes?

Ms. BLUMBERG. That is right, but you may have a very significant increase in your premiums, to the extent that———.

Chairman AKIN. Wouldn't that be the case in a group market as well?

Ms. BLUMBERG. It may be, but when you are talking about in a group market, there is inherently more what we call risk pooling. So there are more people over which the risk is spread.

For example, you think of a firm of 1,000 or more workers. A small number of very sick people in there, those excess costs are spread over a very large group. The impact on everyone's premiums is very modest.

The smaller the group, the more the impact of that excess cost on any particular individual's premiums. In the non-group market, because most states allow you to be rated for premium purposes according to your own health care risk, your own health care situation, the situation is even worse for someone who incurs an illness or a serious injury.

Chairman AKIN. So using a logical extension of what you are saying, it almost sounds like what you are saying is the only thing you would really support would be just sort of a universal coverage, right?

Ms. BLUMBERG. No, that is not necessarily the case. I think you can———.

Chairman AKIN. I have heard the same argument, because we were talking about the AHP's and that was something that a number of us were pushing a couple of years ago. I heard the same complaint there.

Ms. BLUMBERG. Well, AHPs are another mechanism that would affect risk pools.

Chairman AKIN. There is also going to be some cherry picking within. You know like you have ten small businesses. They want to pool and the 11th small businesses got a couple of uninsurable. Well, there is going to be cherry picking within that as well.

Unless you go to a total universal, I mean I don't see how you get out of the box that you are describing.

Ms. BLUMBERG. I can give you a couple of ideas if you would be interested in things that you could do short of going to a full universal system and still taking advantage of the market and the advantages of the marketplace that a lot of individuals favor.

You could, for instance, set up a system where you let the government serve as a public re-insurer. In essence what would happen is an individual incurs a certain level of expenses. You pick a threshold. Maybe it is $10,000 worth of expenses. Maybe it is 15. Maybe it is 20.

When an individual in a particular pool, and this is only one way to structure it, hits that level of expenditures, the government actually comes in and takes on a share of the costs of those particular high cost individuals.

What that does is it takes part of the cost of the high risk out of what could be a relatively modest sized pool, say for small firms in the individual market. You can then finance the payment, the financing for those kinds of public re-insurance mechanisms very broadly, across the entire population, for example, and then the excess costs attributable to each of those very high cost individuals is spread over a much larger group.

You don't have the full cost resting within the insured group. That way the insurers then know that their exposure is substantially reduced, because a huge share of the expenses are attributable to a small number of people. They can then———.

Chairman AKIN. That is interesting. Let me just ask then: Aside from that then if it were found, of course we have already put this into law so it is operative, but if this were to drop the number of people who were uninsured, would you then change your position and think well maybe it is okay or not?

Ms. BLUMBERG. You are talking about the health savings accounts or the tax deductibility?

Chairman AKIN. The health savings accounts and the tax deductibility both.

Ms. BLUMBERG. I think what you are going to see is not an increase in the number of people who are insured. I think you are going to see a switching of who is insured. So you may find some people who———.

Chairman AKIN. You are predicting there will not be a drop in the number of people who are uninsured?

Ms. BLUMBERG. I don't think it will decrease——

Chairman AKIN. As a result———.

Ms. BLUMBERG [CONTINUING]The number of uninsured. I think it has the potential to increase it. I think there is also a strong likelihood that what you are going to see is a switching.

Chairman AKIN. A switching.

Ms. BLUMBERG. So people who currently have coverage lose it and people who didn't have it before who are healthy are taking it up.

Chairman AKIN. I would just take a minute now and let other members of the panel respond.

Mr. PERRIN. Mr. Chairman, if I may, you know sort of the universal attack on health savings accounts is adverse selection and it is something that the Coalition has heard for ten years.

What we haven't heard is any proof. We have heard a lot of comments that this could, this might, this will. Nobody has any proof.

Chairman AKIN. But what you do have proof of is that the number of uninsured is growing tremendously, right?

Mr. PERRIN. You have proof of that and the other proof that you have got is that in 2001, the United States Treasury Department tracked the number of people who were previously uninsured who purchased then medical savings accounts and the number is astonishing.

It is 73 percent. 73 percent of the people who purchased a medical savings account were previously uninsured and they were not just previously uninsured for two weeks.

The definition in the law of the pilot project was that these people had to be uninsured for six months or more. These are chronically uninsured folks.

What Mr. Crane's bill will do is give that waitress at the deli the opportunity to buy a low cost health insurance policy. The uninsured are actuarialy sicker and less healthy than those people who have had insurance. It makes sense and it is in fact true.

How is it that you get adverse selection, but 73 percent of people who purchase the medical savings account are uninsured and in fact actuarialy sicker? Those two things cannot be both true. Somebody is wrong.

When you look at what is driving people out of the market for insurance, the answer is clear. It is cost and at $9,000 a year is a very high hill to climb for most people.

What we are promoting here today, what our Coalition is promoting, is a low cost alternative. If you are uninsured, you have a whole host of problems, not the least of which is that the second largest cause of bankruptcy is uninsured costs. We are talking about moving people from the uninsured column into the insured column.

Let me just say one last thing. Assurant, who is formerly Fordis, announced three weeks ago that the people who are buying their health savings accounts, 30 percent of them are previously uninsured.

Tell me, Mr. Chairman, where that figure is as high in any other type of a health insurance. Mr. Crane's bill will do one thing. It will help the uninsured and that is why it is named that.

Chairman AKIN. Thank you. Kate?

Ms. SULLIVAN. I just wanted to also reinforce and answer your question directly and a little bit of what Dr. Blumberg was talking about.

If you put these tax incentives into the tax code when they are aimed at individuals, will this mean fewer people will have employer based coverage?

We maintain that fewer people are going to have that coverage because of cost. That is the rising cost. There is a lot that we can do in the system to aim there and we have more people who are outside the employer based system for a variety of reasons.

Right now, our only health policy we have today is telling people if you want health insurance, get a job. That is not the right reason to get a job.

We have had people going to mass retailers who offered very good coverage for organ transplants, because that is what their daughter needed and there was no other way for them to get that transplant covered.

People are getting jobs in the hospitality industry, because they run 24/7. They get that second job. We have to do better. We have to do more in the individual market.

The proposal that Dr. Blumberg is outlining, as far as re-insurance, is something to look at as an alternative to simply high risk pools that could be very expensive for those individuals.

Along with tax deductions, you should look at targeted tax credits for individuals within certain income limits so that they don't disrupt that employer coverage, but they reinforce it where it works and unfortunately, it does not work perfectly.

Chairman AKIN. Thank you very much. I don't mean to monopolize the questions. I want to let Congressman Udall also jump in. You can either piggyback or start on your own or whatever you want to do, Tom.

Mr. UDALL. Thank you, Mr. Chairman.

Dr. Blumberg, what is the proof on adverse selection? What is out there that shows adverse selection in HSA's?

Ms. BLUMBERG. We do have a couple of good examples of situations where adverse selection has changed the options available on the market.

A prime example is through FEHBP, the Federal Employees Plan, where originally there were two Blue Cross Blue Shield plans. One a high option that had a very low deductible and another option that had a slightly higher deductible and cost sharing involved.

What happened was over time the healthier individuals migrated into the lower option, the one with the more cost sharing. The higher cost individuals were left in the low deductible plan, and the premiums in the low deductible plan escalated very quickly.

Over a number of years, we now are in a situation where we only have the higher deductible plan. The other one was priced out of existence, even though the difference in the actuarial value of the two plans was not nearly as different as the difference in the actuarial value we see between health savings account type high deductible plans and current comprehensive coverage.

There is also an example from the Harvard Community Health Plan, where the split of selection was very acute and reduced the number of options that they had there.

We don't have a lot of evidence from MSA's at this point, largely because very few employers actually took advantage of them. There was very little enrollment and so when you are talking about a modest amount of participation, you can't expect a big effect on the rest of the community.

I think it remains to be seen what is going to happen, but I think we have enough evidence of knowing that death spirals do occur in insurance markets, that we need to be very wary about it.

Mr. UDALL. The part of this that I think is very dramatic and the Chairman brought this out in one of his questions I think, is what you say in your written testimony, the distribution of health expenditures is highly skewed, meaning that a large share of total health expenditures is attributable to a small fraction of the population.

So where you have a situation where ten percent of any insured population typically accounts for 70 percent of all of the spending of that group, that argues at least to me for some kind of subsidization of insurance coverage for high risk individuals and there are a variety of ways I guess you could do that.

The one that you talked about earlier was where the government at large becomes a re-insurer. Could you talk a little bit about that and why that would make a difference for small business people?

Ms. BLUMBERG. Sure.

Mr. UDALL. You heard my concern earlier. The small business people, the small number of employers have a hard time getting insurance. Why would that help them?

Ms. BLUMBERG. This is actually not much of a problem really for large employers. As I mentioned before, they have a large number of people over which they are spreading their health care risk. A small number of high cost people there, those costs are spread very broadly.

The problem really is in the small group and the non-group market and what happens is because there is far less ability to pool the risk of high cost people for small firms. So when you do have even one very sick person who is employed by a small firm or maybe that small firm worker's dependent, then you can see very substantial increases in premiums year-to-year.

Actually, there is a great persistence in those premium increases. If you have a bad year, someone has a bad year and you are a small firm, your premiums go up substantially in the next year and then even if the health problem is treated and goes away, you still see persistence of those high premiums for a very extended period of time.

If you had some kind of a mechanism, either through re-insurance or some other kind of pool where the government was subsidizing the costs of these high cost cases or the high risk cases, you end up taking away the reason why those premiums are spiking and being so variable year-to-year.

You are taking a very large percentage of the costs for the total population out of the premium base of the small employer or the

non-group market and financing that in a very broad way so the impact of it hits each of us in a much more modest way.

Mr. UDALL. It ends up making it more affordable for smaller business people.

Ms. BLUMBERG. Yes, that is right. You should see the premiums for small businesses——

Mr. UDALL. Go down.

Ms. BLUMBERG [CONTINUING]And individuals' premiums going down substantially as a consequence.

Mr. UDALL. Thank you very much. Thank you, Mr. Chairman.

Chairman AKIN. I thank you all very much for coming out and providing us with really a comprehensive education on the subject and I really appreciate that and look forward to trying to work through all of these problems and solve some of the problems of the uninsured. Thank you.

[Whereupon, at 12:16 p.m., the Subcommittee meeting was adjourned.]

OPENING STATEMENT
18 MARCH 2004

SUBCOMMITTEE CHAIRMAN W. TODD AKIN
SUBCOMMITTEE ON WORKFORCE, EMPOWERMENT & GOVERNMENT PROGRAMS

"Hearing on the Benefits of Health Savings Accounts"

Good morning. I would like to extend a warm welcome to those of you who have taken time out of your busy schedules to testify before this committee today.

Approximately six out of every ten uninsured Americans are in families headed by workers who are either self-employed or work at firms with fewer than 100 employees. It is often the case that the overall cost of health insurance is the greatest barrier to small businesses in providing such coverage to their employees. In fact, annual premium increases of 40 to 50 percent are typical of what small businesses and their employees throughout the nation are experiencing today.

In January, the President noted that the best way to help these families is "to let them save and spend their health care dollars as they see fit." He argued that the federal government must "empower people to make the right decisions with their health care dollars. Give them control of a routine cost so that people see the doctor when they need to, spend their dollars wisely, and still be able to have

coverage for major medical bills." Health Savings Accounts, or HSAs, do just that.

Last fall, with the enactment of the Medicare law, HSAs became available to an estimated 250 million non-elderly Americans. Martin Feldstein, a Professor of Economics at Harvard University and former Chairman of the Council of Economic Advisors argues that HSAs "may well be the most important legislation of 2003."

Under the HSA provisions, consumers can make pre-tax contributions into an HSA account up to their deductible. The HSA earns interest tax free and unused funds can be rolled over year to year. As long as the account is used for qualified medical expenses, it can be withdrawn tax-free. Pre-tax contributions can be made by the individual, employer or family member. Individuals between 55-65 can make pre-tax "catch-up" contributions, which they can use for non-covered Medicare expenses, such as their Medicare premiums. Because the individual owns the account, he may take it with him to another job. Upon death, the HSA can be transferred to a family member.

The issue before us today is to examine the benefits HSAs provide to small business owners. I would like to thank the small business owners and healthcare policy experts who have joined us here today. Before we hear from you, however, my friend and colleague, Congressman Phil Crane of Illinois has been kind enough to speak to us about legislation he recently introduced. H.R. 3901, known as *The HSAs for the Uninsured Act*, would allow an individual to deduct 100 percent of their premiums for high deductible plans that are associated with HSAs. Congressman Crane, thank you for joining us.

Before we proceed with testimony, though, I would like to give our Ranking Member, Congressman Tom Udall of New Mexico an opportunity to say a few words. Congressman Udall?

H.R. 3901, The HSAs for the Uninsured Act

Statement of
The Honorable Philip M. Crane

Before the Subcommittee on Workforce,
Empowerment, and Government Relations
Small Business Committee

March 18, 2004

Chairman Akin and Members of the Subcommittee, I appreciate the opportunity to be here today to discuss my new legislation to help uninsured small business employees and owners.

Just this month alone, over thirty Members of Congress joined me in introducing H.R. 3901, the HSAs for the Uninsured Act of 2004, which I believe will benefit millions of Americans who are struggling with the high cost of health insurance.

Under current law, a health savings account must be purchased in conjunction with a qualified high deductible health plan. Our new bill, the HSAs for the Uninisured Act, allows an inidivdual to deduct 100 percent of the premium of his or her high deductible health insurance if bought in conjunction with a new health savings account. It's an above the line deduction for people who do not have health coverage through their employer.

H.R. 3901 will promote the use of health savings accounts throughout the country and is one of President Bush's top priorities. The premise for this bill is simple – by reducing the cost of helath insurance for individuals, more people will be able to afford it.

Before I describe to you the benefits of my new bill, I first want to talk a little bit about HSAs. Health savings accounts work like an IRA. A person can contribute to a health savings account on a tax-free basis. The account grows tax-free and funds in the account can be withdrawn tax-free for medical expenses.

Many of you are familiar with medical savings accounts, the predecessor of the health savings account, which began as a limited demonstration project in 1996. HSAs are a significant improvement over the old medical savings accounts because they are available to absolutely everyone that wants one. Medical savings accounts had a number of restrictions that prevented their use from becoming more widespread.

MSAs were very successful at making health insurance more affordable for selected individuals. According to the last report of the U.S. Treasury, 73 percent of all MSA buyers were previously uninsured. And, at the end of 2003, MSA policyholders saved about $150 million in their accounts. MSAs provided the majority of its policyholders with health coverage they couldn't find anywhere else and savings to spend on future medical expenses.

Because the medical savings account program was scheduled to sunset in December of 2003, Congress acted last year to create the "next generation" of MSA plans. On December 8, 2003, legislation creating HSAs was signed into law by President Bush, and people have already begun to purchase health savings accounts.

The basic idea behind these accounts is to let people put their own money away for their future health care needs. HSAs are completely portable, and can be used for any health care expense such as prescription drugs or doctor visits.

Under current law, a health savings account must be purchased in conjunction with a qualified high deductible health plan. High deductible health plans are considerably less expensive than traditional health insurance.

The premise behind this requirement is for individuals to use their health savings accounts for their "small" medical bills, like routine doctors visits. The high deductible health insurance is used for "big" medical bills, like hospital stays. Because people get to keep what they don't spend from their account, they will have an incentive to ask for the price before care and check their bill after care to make sure they haven't been overcharged.

Let me explain to you why HSAs are so important for all Americans. Most insured Americans will see an estimated 13 percent increase in their health insurance premiums. This increase follows several consecutive years of double digit increases. These rising costs are driving people out of the health insurance market. Currently, there are more than 43 million Americans without any health insurance at all.

One piece of legislation isn't going to solve this problem. There isn't a simple answer, but there **is** a necessity to take multiple steps now. One of the most important steps Congress can take right now to make health coverage more affordable is to make health savings accounts more accessible. And that's what my legislation does.

H.R. 3109 is the first step toward tax fairness in our health insurance system. All Members in Congress, all of our staff, and probably most of the people watching this hearing get their health insurance tax-free.

Currently, health insurance is tax-free to the employer and tax-free to the employee. Tax-free benefits for health insurance date back to the '40s and '50s. In 1943, the IRS ruled that employer-provided health insurance was tax-free and in 1954, Congress codified that ruling. That has enabled hundreds of millions of families to have health coverage over the years.

As we all know, the economy changes, and as a result, the way in which people buy health insurance changes. For the most part, Congress has kept up with this trend. A few years ago, Congress gave self-employed individuals full deductibility of their health insurance premiums, but our tax policy still leaves the individual purchaser out of the system.

Many of us in Congress have constituents who work for small employers who can't provide health insurance because of the high cost. Our constituents may be waitresses in diners, workers in a dry cleaning store, widows who go back to work as temporary workers, or seasonal workers in the service sector. None of these workers are eligible for tax breaks for health insurance.

It's unfair that some people get tax breaks and some don't – all dependent on whether their employer can offer health insurance, yet that has been our tax policy for 60 years. The HSAs for the Uninsured Act takes the first step towards providing fairness in our health insurance system by giving a tax break to individuals who purchase health insurance on their own.

In a perfect world with an unending supply of revenue, I would like individuals who buy any type of policy to get it tax-free. But with limited revenue, I believe we must start somewhere. We have to target the population who needs help the most – uninsured, working Americans who have to buy their own health coverage. My legislation, the HSAs for the Uninsured Act, does just that while also fostering savings for the future.

Thank you. I would now be glad to answer any questions you may have.

Statement of Ms. Victoria Braden
President, Braden Benefit Strategies, Inc.

On Behalf of
Women Impacting Public Policy

Workforce, Empowerment & Government Programs Subcommittee

House Small Business Committee

March 18, 2004

"The Benefits of Health Savings Accounts"

Mr. Chairman and Members of the Subcommittee, I am Victoria Braden, President of Braden Benefits Strategies, Inc., located in Norcross, Georgia. My company specializes in designing and implementing employee benefit plans for small businesses. I am pleased to appear before you as a member of Women Impacting Public Policy (WIPP), a national bipartisan public policy organization representing 500,000 women in business.

The subject of today's hearing, "The Benefits of Health Savings Accounts (HSAs)" is one I am passionate about because I deal with the issue of employee benefits everyday. As this Subcommittee knows, health benefits to employees, particularly small companies, is one that is vital to the future of this nation's economic growth.

Women Impacting Public Policy (WIPP) commissioned a bipartisan poll of women business owners nationwide in December 2003. Only one in five businesses offer fully paid health insurance coverage. When asked why they do not provide coverage, the majority said it was just too expensive to offer. Women business owners were asked what would cause them to close their business in the next five years. The number one reason was "rising costs" which was further defined as health insurance costs.

Here's what one of my customers, David Carr, CFO, W.H. Bass & Co, had to say about offering health insurance, "Every year, just after we renew our health insurance and then sporadically through out the year, I find myself thinking, what are we going to do next year? We continue to "tweak" the benefits to keep the costs affordable but at what point are we no longer going to be able to make adjustments and then find our health insurance unaffordable either to the company or to our employees or both?" David's remarks articulate the struggle that many small businesses face with regard to health insurance coverage.

One of the bright lights in this rather dismal picture, I believe, is the establishment of Health Savings Accounts (HSAs). It builds on a fundamental principle that employees should share in making decisions about their health care as opposed to relying only on their employers and health insurance companies to make the decisions for them. I want to give you two examples of how Health Savings Accounts (HSAs) will assist my customers in providing better health care coverage and reduce insurance rates.

My first example is Rhodes Young Black and Duncan, a CPA firm with 14 employees participating in the health insurance. The firm pays 99% of the employee cost of the health insurance and employees pay 100% of the dependent cost. Braden Benefits has worked with this business since 2000. In 2000, the cost of an employee's health insurance was $202.00 and the cost of the family was $421.00. Coverage included a $10.00 doctor's office visit co-pay, and a $500 deductible. Even though the company continued to "tweak" their insurance plan in the last four years, significant differences exist in the plan offered in 2004.

In 2004, Rhodes Young Black and Duncan's health insurance plan offers a $30.00 doctor's office visit co-pay instead of a $10.00 co-pay, and a $1,500 deductible instead of a $500 deductible. In addition, in network and out-of-network costs dramatically shifted to the employee during this time period. The cost for the current plan is $283.16 per employee and $842.38 per family. For the employer, the cost per employee has risen 40%, and the cost per family has doubled.

At their renewal, Braden Benefits worked with their carrier, Principal. The numbers showed us that eliminating the doctor's office co-pay altogether and placing all doctor's office charges towards the deductible would save the company between 12 and 24%. With those savings, the company plans to fund an HSA for each employee. The employees will have less

exposure than they have under the current plan because their current $1,500 deductible must be paid as an out- of –pocket expense. With the HSA option, the funds will be available to them in their account which is tax free and allows them to roll over any money they do not spend this year into the following years.

My second example is Johnson Wholesale Floor, an Atlanta based company with 112 employees, which has been in business for 40 years. This is a solid, stable company with branch offices in Florida, Tennessee and Alabama. Braden Benefits began working with this business in 2001 after they realized yet another year of 30+% increases in their health care insurance rates. The situation at this company is that their insurance carrier year after year pays out more in medical claims than they take in premiums. Every year the company receives the maximum amount of premium increase.

In 2001, when the group experienced a 31% increase in its rates, Braden Benefits suggested and made drastic changes to the plan--increased the deductibles, increased the doctor's office co-pays as well as the prescription co-pays, increased the premium the employee paid and reduced the co-insurance. Making these changes resulted in an annual increase of 7% to Johnson Wholesale Floor instead of the previous 31% increase. In 2002, the company, paid less in premiums than the carrier paid in claims, which resulted in a 36% increase in the rates. Johnson Wholesale Floor once again cut benefits, this time even more drastically. They increased the deductible to $1,500, increased the office visit to $25--$35 for a specialist, adjusted the out-of-pocket and reduced the insurance increase to 17% increase for 2003.

As benefits providers, we anxiously await the availability of the HSAs for Johnson Wholesale Floor, knowing that an HSA will prepare the employees at Johnson Wholesale Floor for the expense should he/she needs to use the $1,500 deductible. Currently, it is completely an out -of -pocket expense for the employee. Again, the HSA is tax free and the earnings are tax free, which will help employees with their costs.

As costs are increasingly shifted from employer to employee, the availability of a Health Savings Account will help employees make wise health care choices by allowing them to choose

how to spend their health care dollars. More importantly, HSAs protect employees that do not currently have the ability to pay a deductible, should the employer participate in funding the account. HSAs are a wise tool for employers to use for the following reasons:

One, the majority of employers that we work with are concerned with the increased costs their employees bear and are looking for alternatives. The HSA provides one of those alternatives.

Two, the HSA allows employees to accumulate healthcare dollars over a number of years to utilize at times when they will need healthcare dollars instead of making the calculation on a yearly basis only. It is frustrating to an employee and employer when they have had years of health only to be plagued by a year of difficult health circumstance and have their healthcare expenses wiped out. The HSA allows them to save from the good years for the difficult years.

Let me shift to some of the challenges we face in the commercial market to bring HSAs to our clients. One, we can't get product! We need clarification on several key points that are restraining the carriers from creating and filing products. The following is a list of clarifications the benefits industry needs from the Department of the Treasury to implement the program.

1. What is and is not considered preventive? Can wellness visits have a co-pay? Are prescriptions considered wellness? Can prescriptions have a co-pay and be within the confines of the law? Until we have clarification, the carriers cannot develop product, therefore we do not have anything to offer the companies, at least not from the "A" carriers.

2. Can Flexible Spending Accounts be used with the HSA? If an employee elects an HSA for their employee health insurance coverage, do they forfeit their participation in the companies FSA? If the employee cannot participate in both funds, what effect does this have on the discrimination testing in the account?

Answers to these questions will expedite the offering of HSA products--a very positive addition to the health insurance benefit offerings.

In closing, let me just say that responsible employers do not want to eliminate the doctor visit co-pays, eliminate the prescription co-pays and leave an employee and their family without the means to afford health insurance. They want to provide health insurance for their employees. At the same time, they struggle to get health insurance costs under control. I believe HSAs, used pro-actively to promote options to businesses and their employees, gives both employers and employees new options which will have a positive effect on small businesses.

Thank you, Mr. Chairman. I am happy to answer any questions.

"The Benefits of Health Savings Accounts"

TESTIMONY
of the
U.S. CHAMBER OF COMMERCE

by

Kate Sullivan
Director, Health Care Policy

before the
U.S. House of Representatives
Small Business Subcommittee on
Workforce, Empowerment and Government Programs

March 18, 2004

The U.S. Chamber of Commerce is pleased to testify at today's hearing about the benefits of Health Savings Accounts. I am Kate Sullivan, the Chamber's director of health care policy, and I have been involved in health care policy for 18 years as a staff advisor in the U.S. House of Representatives, to a former state governor and in various capacities in the private sector. The U.S. Chamber of Commerce is the world's largest business federation representing employers of every size, sector and region, and has engaged for a number of years in advocating that all Americans have health coverage through an appropriate mix of market reforms, public financing and a meaningful safety net. Moreover, everyone in this country, whether privately covered, publicly subsidized or uninsured, has a right to expect that our health system has at its root the best possible quality with uncompromising standards of safety.

Enactment last year of Health Savings Accounts came at a critical time for America's employers and working families. There is much they offer not only small business, but for workers at any point in their lives – particularly those times when

they are not working. I will discuss here the importance of ensuring healthy market competition, into which HSAs are a welcome entrant, to help lower health care costs and improve our health care system. An ideal health system involves many elements that must work together, a few components of which are private sector choices, effective use of the tax code and greater use of information.

Reducing Health Insurance Costs through Market Competition

The insurance market, particularly for small businesses, has largely stagnated over the last five years. Time and time again since the late 1990s, small businesses have been forced to get a new health plan because their insurer has left the marketplace. Other employers have found that they have no other insurers in their area to call for a rate quote when their current plan premiums skyrocket. This lack of competition stems from state mandates on health plans, which have taken away health plans' ability to differentiate themselves in the marketplace and compete for customers by offering benefits tailored to meet their needs. When carriers leave the market, they leave employers with one less place to go with their business, and concentrate the market power of one or two dominant insurance companies. Health Savings Accounts hold the promise of reviving the largely moribund but costly small business insurance market.

HSAs were established in the Medicare prescription drug law and went into effect January 1, and will replace its more restrictive Archer MSA predecessor. While a number of larger employers have experimented with so-called "consumer-driven health plans" made possible by health reimbursement arrangements ("HRAs"), non-discrimination compensation testing largely prohibit these plan designs for some small businesses and partnership arrangements.

The HSA Advantage

Along with injecting new competition for employers' premium dollars, HSAs also offer a number of advantages for employees. Of primary benefit, the account is held exclusively by the taxpayer, rather than the employer. Employers may contribute to the HSA (as may the employee), easing concerns for younger or less affluent workers about funding their deductibles. As with other compensation requirements, employer contributions must be made fairly across the employee base, and HIPAA compliance will require that contributions not vary based on an employee's health status.

HSAs will jump start the small group health insurance market in 2004. Many small businesses have already been forced to adopt higher deductible health plans as insurance costs nearly doubled over the last five years. Insurers specializing in these kinds of health plans will enter states where they had once done business and left, or will become new market alternatives to the one dominant insurance carrier serving the small group market. Traditional insurers will also offer HSA products in an effort to retain small business customers. Small businesses desperately need this market competition for their substantial premium dollar.

HSAs also offer a pre-tax mechanism for paying for insurance when the account holder does not have workplace coverage, the first time the tax code has made this allowance. Premiums may be paid from HSA balances, though annual contributions are still restricted to the amount of the annual deductible. Therefore, greater tax code equity changes must still be made. President Bush and Congressman Crane have put forth important proposals toward this goal.

Tax Code Parity for Individuals without Employer-Sponsored Coverage

The U.S. Chamber of Commerce supports H.R. 3901, which would provide a full tax deduction to individuals who purchase qualified high-deductible health plan coverage in conjunction with Health Savings Accounts (HSAs). Currently, tax preferences for the purchase of health insurance are available only to individuals with workplace health plans and the self-employed.

Providing tax code parity for the millions of taxpayers who acquire their own health coverage in the individual market has been a major priority of the Chamber. When combined with the additional HSA incentives to obtain cost-effective medical treatment that meets their personal needs, millions of Americans will be able to obtain far more affordable health coverage.

Changing tax policy to provide equal tax treatment for the purchase of health insurance is the right thing to do, particularly as an increasing number of people lack access to employer-based coverage. The declining availability of retiree health coverage means more individuals who are not yet eligible for Medicare will pay for their own health coverage with after-tax dollars. Furthermore, more people are pursuing either higher education later in life or non-traditional careers, and they should have tax incentives to acquire health coverage when they are young and healthy. We would encourage the Congress not to limit the important goal of tax code parity just to one type of health plan design, though beginning with HSA coverage is a good first step.

Targeted Tax Credits Also Needed

In addition to tax deductions for individually purchased health insurance, the Chamber believes additional measures are required to provide resources to lower-

income individuals who pay no taxes but need assistance with their health insurance premiums. Everyone who pays their own insurance premiums should be able do so on a tax-preferred basis.

Refundable tax credits for those with modest incomes will help many uninsured individuals obtain affordably priced basic health insurance. The Chamber supports the following principles for enactment of a tax credit:

- Tax credits should be income-related in order to avoid wholesale disruption of employer-based coverage. An employer will not drop its workplace health plan if only some employees are eligible for federal assistance.
- The value of a tax credit should be a sliding scale percentage of the premium for the covered individual. Health premiums vary widely based on geography, age and, of course, health status. Those with greater need should receive more assistance.
- Partial tax credits should also be made available for income-eligible workers who pay a substantial portion of premiums for themselves or dependents.
- The value of a tax credit should be advanced into workers' paychecks through W-4 withholding forms.
- A full tax deduction should remain an option for all taxpayers. As incomes change, the tax code should offer proper assistance and relief for those who obtain and retain coverage.

Flexible Spending Account Changes Long Overdue

Long before HSAs came into being, many employees already had experience with health care flexible spending accounts ("FSAs"). These are accounts established under Section 125 flexible benefit plans to pay health care costs not covered by one's health plan, such as contact lenses, over-the-counter medications, dental care, co-payments and deductibles. However, employees must budget carefully: unspent funds at the end of the year are forfeited to the employer. Consequently, only 34 percent of eligible employees participate in their workplace FSA, and many under-budget their need.

FSAs will continue to be part of the mix of employee benefits even as HSAs are adopted. For those without an HSA, a major advantage of health care FSAs is that employees may access at the start of the year the entire amount they have budgeted for the year and then repay the funds with each paycheck. This feature is particularly valuable for those with more modest incomes as they won't have to break the family budget in order to meet a deductible at the start of the year.

The current "use it or lose it" rule has several ill effects on patient-consumer behavior. First, employees who find themselves with unspent balances as they approach the end of the plan year often embark on a spending spree for health care goods and services that they may not need just to avoid forfeiting their hard-earned money. Other employees budget too conservatively for their out-of-pocket expenses and end up paying more for those same costs than if they had paid them on a pre-tax basis through an FSA.

Employees should be able to carry over to the next year up to $500 of unspent funds or designate unspent funds to a qualified retirement savings plan, allowing them to reap the benefit of long-term growth and a more financially secure future.

Employees should also be allowed to withdraw their entire balance on an after-tax basis: It's their money, let them have it back! Moreover, because the employee receives the funds on an after-tax basis, this option is also less costly to the federal government to enact. Congressman DeMint has proposed legislation accomplishing these goals, and the Chamber is working with several other members of Congress committed to making these improvements which, if done in the manner outlined here, will cost little to implement.

Reducing Health Care Costs through Better Information

To work most effectively, all health system users, but especially those with Health Savings Accounts and other plan designs which encourage active consumer behavior, must have far better information about the medical delivery system than exists today. Information is an important component to reducing costs and ensuring good outcomes – whether that information is about provider performance, best treatment options, available health plan choices or ways to improve one's own personal health. Components of better information to improve quality and lower costs include:

- Sharing information about provider performance
- Developing evidence-based protocols to reduce practice variation
- Eliminating medical errors through greater use of technology-based information systems
- Steering patients to providers dedicated to quality improvement and best practices
- Disclosing the cost of items and services so patients can, when appropriate, compare prices relative to benefit

There is growing consensus among a broad array of federal and state lawmakers, and business, labor and consumer stakeholders around the importance of public reporting of health care quality and efficiency measures, including those that measure clinical outcomes, the patient's perception of care and relative efficiency. Valid, reliable, comparable and salient quality and efficiency measures have been shown to provide a potent stimulus for clinicians and providers to improve the quality and cost effectiveness of the care they provide. Employers spend more than $400 billion annually on workplace health care benefits and therefore have a vested interest in ensuring the highest quality and most cost-effective care possible for their employees, retirees and their dependents.

Consequently, the Chamber has endorsed "The Quality Initiative," a voluntary reporting system of hospitals in 10 standardized protocols relating to three diagnoses. An additional 12 protocols have been identified for reporting in early 2005, including three related to surgical infection. Medicare will soon begin paying an enhanced inflation adjustment to hospitals that report this information. Voluntary public reporting will give employers and consumers needed information about the quality and efficiency performance of the health care system and help them to make more informed decisions about their care, and health plan designs will encourage those informed choices.

Further research into clinical treatment protocols will enhance patient care, reduce practice variation and health care disparities, and improve patient outcome. This research should be supported in the public and private sectors, its results widely disseminated, and the ensuing protocols incorporated into reimbursement systems. Providers should be rewarded for being efficient and treating patients successfully the first time; the current system pays to correct each medical complication, side effect and even error. Employers do not wish to spend their health care dollars in such

haphazard fashion, and some are revising their payment systems to promote efficient care. Medicare is also experimenting with such an approach, and we encourage these developments.

Similarly, employers have demanded greater use of technology based systems for patient care, resulting in more electronic records and prescription ordering, minimizing the chance of handwriting errors and speeding information retrieval in easily sorted formats.

HSAs and Tax Incentives Augment, not Undermine, Employer Coverage

Critics of market-based health care solutions are working overtime to convince policymakers that the widespread use of Health Savings Accounts and health insurance tax incentives aimed at individuals will undermine the employer-based health system. In fact, such windmill-tilting exercises divert attention from the true enemy of the system on which 136 million American employees of private employers and their dependents rely: COST.

No longer can employers allow dollars that should go into paychecks – and eventually to be recirculated into the economy – instead go to insurance premiums and the health system as a whole when so little accountability is demanded. HSAs and their companion health plans can improve this situation, and return more of one's paycheck to other sectors of the economy.

National Association for the Self-Employed

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Testimony of

David Alders, Member of
The National Association for the Self-Employed

House Small Business Committee
Subcommittee on Workforce, Empowerment and Government Programs

"The Benefits of Health Savings Accounts"

March 18, 2004

Mr. Chairman and members of the Subcommittee, it a distinct privilege to be with you today to testify on one of the critically important issues facing almost every American family, including my own: that of affordable access to quality health care. My name is David Alders, and I am the owner of a small, diversified agribusiness enterprise in Nacogdoches, Texas. I am here today representing the National Association for the Self-Employed and its 250,000 member businesses representing well over a half million individuals across America.

The NASE represents the smallest of America's small businesses, those which often are in the process of being bootstrapped by owners whose vision and ambition outstrip their capital or credit but who enthusiastically incubate the American dream and who collectively are a major force for job creation in our economy. Because our margins generally are as thin as our lines of credit, ours is the sector which perhaps is most squeezed by America's health care cost crisis. Census data indicate that of the approximately 43 million Americans without health insurance, 62 percent are from families in which the household head is either self-employed or working for a company with fewer than 100 employees. The reason this group disproportionately neglects to secure health care coverage is easily understood: on average, workers in firms with fewer than 10 employees pay 18 percent more for health coverage than those who work in larger firms. According to a June 2002 study released by the NASE entitled "Affordability in Health Care: Trends in American Micro-Business," seven in 10 micro-business owners report they do not provide any type of health care coverage to eligible employees nor have coverage for themselves. Costs are cited as the chief reason for this trend. Participants in the study say the situation is worsening as health insurance premiums for micro-businesses are increasing at double-digit rates while insurance benefits and plan choices are decreasing.

We at the NASE are convinced that America is blessed with the finest health care system in the world and that it so blessed because of and not in spite of its reliance on market forces. Can market mechanisms eliminate every unfortunate human experience in the delivery of health care? Certainly not; private charity and a social safety net have necessary roles to play. But, as Tom

Miller has written, "unlike centralized government 'solutions,' markets do not promise perfect outcomes, just better ones." Market-based reforms begin with more neutral tax treatment of health insurance purchasing options, insurance options, which emphasize protection against major risks, and deregulation of health care suppliers. Instead of more regulation and litigation, such reform underscores the primacy of voluntary contracts and market prices.

In short, the ultimate market-based reform is to guarantee that the health care consumer is also the health care billing watchdog. Health Savings Accounts coupled with high deductible health insurance plans work splendidly to accomplish this basic measure of market accountability. My business has taken this approach for several years, maintaining adequate, though decreasingly affordable, coverage due chiefly to ever-escalating deductible thresholds. Health Savings Accounts now offer me the opportunity to set aside pre-tax dollars to fund care which is relatively minor or merely palliative, and gives me the incentive to carefully question whether I need to access the system at all, a question which a meaningless $10 co-pay in a conventional plan will always lead a consumer to answer in the affirmative.

Also, Health Savings Accounts alleviate some of the burden faced by micro-business owners as they attempt to attract skilled, competent workers. Micro-business owners are unable to offer the extensive employment packages that large companies give to new employees. In fact, many micro-business owners are unable to provide any type of health insurance to their employees. According to the NASE's 2002 study, only twelve (12%) percent of respondents stated that their company was able to offer health insurance coverage to their employees. Seventy-eight percent (78%) of respondents felt that even if they did offer coverage, their employees could not afford to cost share on the expense of that health insurance. However, with the creation of HSAs, employers can contribute annually to their employee's health costs. Micro-business owners who have been unable in the past to offer a health benefit to their employees, now have a valuable benefit to offer current employees or potential employees.

To further enhance the appeal of HSAs, we strongly support the passage of H. R. 3901, which would allow individuals who purchase high-deductible insurance policies and also fund HSAs to

deduct the value of their insurance premiums from their income taxes. Heretofore, the self-employed and small business owners have been discriminated against by having to purchase their health care coverage with after-tax dollars and by in effect having to pay self-employment payroll taxes on their health insurance premiums. Starting and expanding a competitive small business is difficult enough without having to pay an additional 15.3% tax on one's insurance premiums.

Of course, H. R. 3901 applies only to those taking advantage of HSAs, and we believe this disparity in the tax code ought to be remedied and removed regardless of whether a small business owner funds an HSA. H. R. 1873, the Self-Employed Health Care Affordability Act, would allow the self-employed to fully deduct their health insurance premiums and thereby achieve parity with corporations, which provide their employees health care coverage and deduct the costs thereof as an ordinary business expense. Our members would greatly appreciate your support of both these important pieces of legislation.

Under the current tax code, it is no wonder so many American workers who lose employer-based insurance rationally choose to direct their discretionary resources away from their health insurance budget to personal transportation and recreation and entertainment. As long as they're being discriminated against, they adopt the philosophy, "Don't worry, be happy." I think it is incumbent upon us to remember that when a lifetime of health insurance premiums represents a sum in excess of the net worth which these people likely will accumulate over that lifetime, they understandably ask, "Now, remind me, why am I buying health insurance?"

We are not under the illusion that tax code changes and the creation of HSAs alone constitute a silver bullet which will solve America's health care cost crisis, but they are a welcome step toward consumer-driven health care. We hope subsequent steps include the reintroduction of other free market principles to the American health care system wherein buyers and sellers of care and insurance can communicate without the distorting static of governmental inference.

The Galen Institute brought to Capitol Hill last month six of the leading vendors of Health Reimbursement Arrangements such as MSAs or HSAs. The experience of these vendors is that the people who utilize these vehicles tend to be older and slightly sicker than those who do not. But they also tend to make much better use of preventive services, use generic drugs much more, use hospital ERs much less, access supportive services like nurse hotlines much more, and generally have been holding down costs significantly. In short, the market works when given a chance, and people will spend their own money more wisely than they will spend someone else's.

If in future years we destroy this healthcare system which is the envy of the world, which offers the best medical treatment a lot of money can buy, and to which the wealthy of the world repair when they need repair, we will have done the poor and needy as well as middle class and affluent Americans a huge disservice. The older I get the more I want to see an increasing rate of innovation in medical technology and in research and development of new pharmaceuticals. I know enough about economics to know that there is a reason America has the world's finest healthcare and that it rests and runs on the decentralized profit motive rather than the centralized dictates of a single-payer.

I am grateful for all of you who are working to contain costs while protecting the quality of our system. Preserving the world's finest healthcare system is worth the effort, and American's employers and employees are counting on your success. Thank you.

Testimony of Mr. Daniel B. Perrin,

Executive Director of the HSA Coalition,

before the

United States House of Representatives

Committee on Small Business,

In the Subcommittee on

Workforce, Empowerment and Government Programs

in the Second Session of the 108th Congress

on Health Savings Accounts

Thursday, March 18, 2004

Mr. Chairman and Members of the Committee on Small Business, thank you for inviting the HSA Coalition to testify here today. The HSA Coalition is a coalition of non-profit groups that advocate for Health Savings Accounts.

Mr. Chairman, the most consumer friendly form of health insurance is affordable health insurance, and Health Savings Accounts are affordable.

Health Savings Accounts simply refinance your health insurance. Instead of paying $700 or $800 a month for a family health insurance premium, you pay $235 a month for a high deductible policy, and take the $500 a month you are saving and instead of sending it to an insurance company, you put it in your Health Savings Account, tax free.

Mr. Chairman, and members of the Committee, Exhibit A is an actual example of a Heath Savings Account now being sold in Florida in the individual insurance market. This example is for a 40 -49 year old non-smoker.

As you can see, even by fully funding the Health Savings Account to $5,150 a year -- more than $1,000 is saved over what was spent on last year's health insurance.

Health Savings Accounts allow individuals to save on the cost of health insurance in two ways:

1) the immediate cost of their health insurance drops; and,

2) the rate increases from year to year are far less than the double digit increases we have seen over the last four or five years.

Further, because consumers are spending their own money out of their health savings account, their behavior changes. The effect on consumer behavior is like the difference between going out to dinner on an expense account, or going out to dinner and paying for it with your own money. With the Health Savings Account, you are spending your money, not the insurance company's.

Mr. Chairman, the CATO Institute had a Medical Savings Account (which was the pilot version of the Health Savings Account) from January 1, 1997 through December 31, 2003 . During that time their staff grew substantially, but their per person health care costs declined.

How many times, Mr. Chairman, has someone come before this Committee and said that the course of the last seven years, their cost of health insurance has declined?

Forbes Magazine also had Medical Savings Account, and for five years, they did not have a single premium increase.

The Third Party Payer Effect on Health Spending

Mr. Chairman, the Joint Economic Committee graph, which is attached as Exhibit B, shows as clearly as possible why health care costs in the United States have

exploded over the past thirty years. Over time, third parties (insurers) paid more and more of the insureds bills. The insureds, and in many cases the doctors, had no understanding of the cost of something, in relation to its benefit. The result was that as out-of-pocket expenditures declined, health care costs went up.

In short, Health Savings Accounts will push up out-of-pocket spending (the red line) and push down the cost of health care (the blue line).

The other key advantage to a Health Savings Account is that if the money is not spent, it rolls over and builds up in the account. Mr. Chairman, Exhibit C is a chart showing several possible scenarios of money building up under various time and expense scenarios. The build up of funds illustrated by Exhibit C does not assume the maximum deposit of funds in the Health Savings Account, so this chart does not represent the largest deposits that could build up in the Account. For example, the maximum deposit for a family into a Health Savings Account in 2004 is $5,150, Exhibit C assumes a deposit of $4,000 a year.

In order to help insureds manage and invest this HSA money, UnitedHealth Insurance has announced that it is starting its own bank. Assurant now allows its customers to select various HSA investment options for their HSA funds. On a national scale, Health Savings Accounts will slowly redistribute funds now spent on traditional low deductible insurance, and instead be deposited into individually owned Health Savings Accounts.

The HSA Marketplace

The Health Savings Account market place is growing rapidly, both in the number of insurers and in the number of customers. Today, in every single one of the fifty states, you can purchase a Health Savings Account insurance policy. There are thirty insurers now in the marketplace, and another ten insurers have already announced they will soon be selling HSA policies. One senior executive at a HSA trustee company, that is a company that manages HSA accounts said recently that their business in doubling every month.

In mid February, about one month ago, the National Association of Underwriters held a webview/teleconference for its members on Heath Savings Accounts. They had ten times the normal number of subscribers of insurance agents and brokers (more than 1,000) who reported an enormous amount of interest from employers whose size runs the gambit of small to very large.

According to the HSAInsider (www.hsainsider.com) Mr. John Greene of the National Association of Underwriters said, "I go to events all the time, and that is all people are talking about – Health Savings Accounts, and they have not even been in existence for two months."

Mr. Chairman, Mr. Crane's bill will finally give the individual in the individual insurance market tax parity with those who have employer provided health insurance. Today, those who arguably need the tax break for health insurance the least, those

whose employer provides health insurance, are the only ones in the United States who get the tax break. Meanwhile, the waitress at the corner deli, who has to buy her own health insurance, gets no tax break. By starting to provide individuals an equal tax break if they purchase a Health Savings Account, Congress will be aiming this policy solution directly at the uninsured.

In 2001, when the Department of the Treasury last tracked the number of uninsureds who purchased a Medical Savings Account, it was an astonishing 73%! Roughly three out of four people who purchased a Medical Savings Account were previously uninsured. Assurant reports now that 30% of the people purchasing their Health Savings Accounts are previously uninsured, not a likely statistic you will find among other types of health insurance.

Why were three of four MSAs purchased by the uninsured? The reason is straight forward, high deductible health insurance premiums are affordable.

Mr. Crane's bill, H.R. 3901, will enact President Bush's proposal to provide individuals with an above the line tax break for the cost of their HSA insurance premium.

Finally, Mr. Chairman, the most compelling reason for Congress to pass H.R. 3901 is that it will make health insurance affordable for millions of Americans.

(As further background, please see the following, which are attached: Exhibit D addresses the issue of why the less healthy have incentives to choose a Health Savings Account; Exhibit E for general overview of the current high cost of health care in the United States; and Exhibit F, showing the broad support for Health Savings Accounts at the time the provision was being debated by Congress as part of the Medicare Prescription Drug bill.)

Exhibit A

Comparing Current Health Insurance Costs to Current Health Savings Accounts

$755.67:	Average monthly premium for average 2003 Family Health Insurance
$9,068:	Annual 2003 Cost of Family Health Insurance in the U.S. according to the Kaiser Foundation

Family Medical Savings Account Offered in Florida[1]

$234:	Monthly Premium for a $5,150 Deductible HSA Family Health Insurance Policy (40 to 49 yr. old primary insured)
$2,808:	Annual Premium for a $5,150 Deductible Family Health Insurance Policy
$5,150:	Funds Go into Your Pocket in your Health Savings Account instead of being sent to an insurance company
$7,958:	Total cost of Premium and 100% Funded HSA

Compare Costs:

$9,068:	Annual 2003 Cost of Family Health Insurance in the U.S. according to the Kaiser Foundation
$7,958:	Total cost of Premium and 100% Funded HSA
$1,100	**Savings a Year with a Fully Funded HSA**

[1] Name of insurer available on request

Exhibit B

http://jec.senate.gov/_files/HSAWebChart02252004WIY.pdf

Exhibit C

Possible Build-Up of Savings For Families With An HSA Under Different Time and Medical Expense Scenarios

Account Balance After X Years	Age of Head of Household Starting at 30	Health Savings Account Balances (Assumes a $4,000 Deductible and Deposit Each Yr)		
		After Family Medical Expenses of $1,000 Each Yr	After Family Medical Expenses of $500 Each Yr	Zero Family Medical Expenses
5 Years	35	$17,406	$20,307	$23,208
10 Years	40	$39,620	$46,224	$52,827
15 Years	45	$67,972	$79,301	$90,630
20 Years	50	$104,158	$121,517	$138,877
25 Years	55	$150,340	$175,397	$200,454
30 Years	60	$209,282	$244,163	$279,043
35 Years	65	$284,509	$331,927	$379,345

Assumes 5% interest per year, and 100% of a $4,000 deductible is deposited each year. One Medical Savings Account insurer has paid 5% interest on balances in their Medical Savings Accounts since January 1, 1997, and has not changed their interest rate since 1/1/97. Source: The HSA Coalition

Possible Build-Up of Savings For Individuals With An HSA Under Different Time and Medical Expense Scenarios

Account Balance After X Years	Age of Individual Starting at 25	Health Savings Account Balances (Assumes a $2,000 Deductible and Deposit Each Year)		
		After Individual Medical Expenses of $1,000 Each Yr	After Individual Medical Expenses of $500 Each Yr	Zero Individual Medical Expenses
5 Years	30	$5,802	$8,703	$11,604
10 Years	35	$13,207	$19,810	$26,414
15 Years	40	$22,657	$33,986	$45,315
20 Years	45	$34,719	$52,079	$69,439
25 Years	50	$50,113	$75,170	$100,227
30 Years	55	$69,761	$104,641	$139,522
35 Years	60	$94,836	$142,254	$189,673
40 Years	65	$126,840	$190,260	$253,680

Assumes 5% interest per year, and 100% of a $2,000 deductible is deposited each year. One Medical Savings Account insurer has paid 5% interest on balances in their Medical Savings Accounts since January 1, 1997, and has not changed their interest rate since 1/1/97. Source: The HSA Coalition

Exhibit D

WHY THE LESS HEALTHY WILL CHOOSE AN HSA

There are two key reasons the less healthy will choose an HSA.

The first reason is to have control over their own health care decisions, and treatments, including what kind of prescription drugs they take.

With an HMO, the sick must face the rationing regime in place by HMOs to contain costs, which includes a frustrating waiting list to see a specialist and treatment and prescription drug formularies that may not have the most up-to-date treatments or brand name drugs that would make them feel the best.

The second reason is a financial incentive.

Assuming the less healthy would rather not be in an HMO or other managed care plan, then they would likely choose a fee-for-service plan. The standard fee for service plan has a $500 deductible, with a 20% co-pay of the next $5,000. This means the person would pay $500 for the deductible, and $1,000 for the 20% of the next $5,000 before being covered 100%.

That is $1,500 in after-tax income to be insured 100%.

With a Health Savings Account, the same individual would pay a much smaller premium, and in many cases have a majority of the deductible deposited in their Health Savings Account.

With a $1,700 deductible, and, say $1,500 deposited tax-free in the Health Savings Account, the less healthy individual with an HSA would have to come up with $200 in after tax money to be covered 100%.

On one hand the less healthy would have $1,500 in after-tax funds to pay to be covered 100% by their insurance, and on the other hand, with an HSA, would have to come up with $200 in after-tax money to be covered 100%.

The less healthy, therefore, have a financial incentive to choose a Health Savings Account, in addition to having the incentive of controlling their health care.

Exhibit E

The Current Political and Economic Environment Created by Health Care Costs in the United States

1) The rising cost of health insurance is forcing a new dynamic into the ongoing political debate:

UPI: Average Cost of Health Insurance for a Family is $9,068/Yr

http://www.upi.com/view.cfm?StoryID=20030912-012028-8736r

Here are the key quotes from the UPI story:

"WASHINGTON, Sept. 13 (UPI) -- No one should have been surprised to learn this past week that health insurance premiums rose 13.9 percent this year. Fair warning -- they will be moving up by double-digits next year, too.

Employers pay, on average, 73 percent of the cost of a family's health insurance policy -- which now averages about $9,068 a year -- putting it out of range for many self-employed workers."

CBS MarketWatch: 12% Increase Next Year will mean Health Costs Have Doubled Since 1999

http://cbs.marketwatch.com/news/story.asp?guid={3021EA14-4C6E-4C59-ADA6-575C0F06408C}&siteid=google&dist=google

The text of the CBS MarketWatch article says:

"The cost of medical benefits is expected to rise 12 percent or more next year. At that pace, benefits costs will have doubled since 1999. Having already passed on deep cost cuts to doctors, hospitals and HMOs, now employers will continue to push more benefits costs on to their employees."

2) These cost increases are driving health care politics:

"Wal-Mart Stores Inc. Chief Executive Lee Scott said Sunday that soaring health-care costs were among the biggest challenges facing retailers and called on the U.S. government to help. In a speech to the National Retail Federation convention in New York, Scott said the U.S. health-care system was in 'crisis.' 'We believe it is time for the government to step in ... and get a handle on health-care costs,' Scott said. He gave no examples of potential remedies."

"Wal-Mart CEO on Health Costs," January 12, 2004, The Los Angles Times (from Reuters) http://www.latimes.com/business/careers/work/la-fi-storyc12jan12,1,3411667.story?coll=la-headlines-business-careers

3) The employer provided health insurance base is shrinking, and is now at 45%, down from 63% ten years ago. At the current rate of decline, roughly 36% of the population will have employer provided health insurance in five years.

Dallas-Fort Worth Star Telegram: Serious Condition

http://www.dfw.com/mld/dfw/news/7051416.htm

The key quote from page three of the article linked above:

"Just 45 percent of employees nationwide had workplace-based health insurance in March 2003, down from 63 percent a decade earlier, according to data released last month by the U.S. Bureau of Labor Statistics."

4) Free market health care forces should not be surprised by polls like this, nor should they dismiss them:

Newsday: Poll: 2/3 of the U.S. Public Supports Government Run Health Care for All

http://www.newsday.com/news/health/wire/sns-ap-health-care-opinion,0,7411822,print.story?coll=sns-ap-health-headlines

The article is quoted below:

By almost a 2-1 margin in this poll, 62 percent to 32 percent, Americans said they preferred a universal system that would provide coverage to everyone under a government program, as opposed to the current employer-based system.

5) One of the only ways to cut health insurance costs, and decrease medical inflation, is with a Medical Savings Account (renamed Health Savings Accounts in H.R. 1):

MSN Money: A Health Care Plan that Can Save You Thousands

http://moneycentral.msn.com/content/Insurance/Insureyourhealth/P35610.asp

Here is a quote from the MSN Money article:

"The monthly premium cost for that high-deductible medical insurance plan might be $377 for a family of four, versus $729 for the traditional plan. That means a savings of $4,224 annually on insurance premiums -- more than enough to fund an MSA"

6) These facts are why Speaker Hastert has stated that the Health Savings Accounts are the most important part of H.R. 1.

WSJ: Medicare Rx Conferees Focuses on Employer Benefits

http://online.wsj.com/article/0,,SB106616869880526200,00.html

Here is Speaker Hastert's quote from the Wall Street Journal article:

"Mr. Grassley said lawmakers also are planning to include a House provision creating tax-preferred health savings accounts, which individuals, not just Medicare beneficiaries, could use to fund out-of-pocket medical expenses. **The accounts -- which House Speaker Dennis Hastert (R., Ill.) called the "most important piece in the bill" -- could help win support from wavering House conservatives.** "

7) And, MSAs will help to lower the number of the uninsured:

The Bakersfield Californian: Dentists Backs MSAs

http://www.bakersfield.com/opinion/story/3902397p-3925496c.html

Quoting the Bakersfield Californian article:

"The IRS revealed that 73 percent of all people who purchased an MSA in 2001 were previously uninsured. That percentage has never been lower than 32 percent since MSAs were first made available to a limited number of Americans in January 1997. In fact, the percentage of previously uninsured people using MSAs has increased every year since their debut."

8) Senator Kerry's position on Health Savings Accounts:

Quoting the Guardian:

"Sen. John Kerry: 'Health savings accounts are not the answer to rising health care costs. They primarily benefit healthy, upper-income Americans while doing little to expand coverage. I have proposed a comprehensive cost containment plan which will allow families to save as much as $1,000 a year on their premiums and which does not leave the poor and the sick behind.'"

Candidates on the Issues: Health Care, The Guardian, Thursday February 12, 2004 8:16 PM, **http://www.guardian.co.uk/uslatest/story/0,1282,-3741298,00.html**

Exhibit F

[As delivered on 11/6/03.]

November 6, 2003

The Honorable Dennis Hastert
The Speaker
The United States House of Representatives
Washington, D.C. 20515

BY HAND

Dear Mr. Speaker:

A recent ABC News-Washington Post poll found that 2/3 of the American public supports government run, universal health care. This poll is simply a political reaction to the increasing cost of health care. Consistent cost increases over the past four years are beginning to negatively impact the public, and will have political repercussions unless health care cost inflation is tamed.

The average family health insurance cost in the United States in 2003 is $9,068. Recent news reports have stated that a 12% increase next year, will mean that the cost of health care will have doubled in the United States since 1999.

The free market, if allowed to function, will contain these costs through permanent and unrestricted Medical Savings Accounts, renamed Health Savings Accounts in H.R. 1.

A Medical Savings Account along with a high deductible policy will save between 20% and 60%, and the out year cost increases of the annual premium of a medical savings account will be far less than the double digit increases over the past four years.

Furthermore, the savings build up from owning an MSA, and the ability to take it from job to job, makes it an essential public policy to be enacted into law, so that Americans can have the opportunity to build up funds for that time when Medicare is not able to provide the same level of support and benefits it does today.

Therefore, we the undersigned, support you and the President, and support the passage of the H.R. 1 Conference Report. We believe that the cost containment effects of MSAs, and the ability of Americans to build up a surplus in their MSA, is essential to the continued viability of the free market health care in the United States.

Sincerely,

60 Plus Association
AAHP-HIAA
American Association of Patients and Providers
American Defense Council
American Dental Association
American Farm Bureau Federation
American Federation of Senior Citizens
American Health Resources
American Taxpayers Alliance
Americans for Intelligent Healthcare Reform
Americans for Tax Reform
answerfinancial.com
Benefit Administrators
BenefitRates.com
bestquote.com
cchc-mn.org
Center for Individual Freedom
Christian Coalition of America
Christian Voice
Citizens' Council on Health Care
Citizens for Conservative Government
Club for Growth
Communicating for Agriculture and the Self Employed
doctordirectory.com
Eagle Forum
euCareSolutions.com
Evergreen Freedom Foundation
Family Research Council
First MSA, Inc.
Frontiers of Freedom
Golden Rule
healthaxis.com
healthmoney.com
HealthSource
Hispanic Business Roundtable
Independent Bakers Association
International Mass Retail Association
Mactavish Benefits
Medical Savings Accounts, Inc.
MSA Bank
MSA Education and Political Promotion Initiative
MSAExpress.com
MyChoiceHealth.com
National Association for the Self Employed
National Association of Alternative Benefit Consultants
National Association of Health Underwriters
National Federation of Independent Business
Prime Health Care Inc.
quickquote.com
Republican Leadership Coalition
simplecare.com
simplyhealth.com
Small Business Survival Committee
The Seniors Coalition
The Society for the Education of Physicians and Patients
Traditional Values Coalition
Triangle Medsaver Inc.
United Seniors Association
U.S. Freedom Foundation
Washington MSA Project
webhealthy.com

Health Savings Accounts and Tax Preferences for High Deductible Policies Purchased in the Non-Group Market: Potential Impacts on Employer-Based Coverage in the Small Group Market

Statement of

Linda J. Blumberg, Ph.D.

Senior Research Associate
The Urban Institute

Small Business Committee
Subcommittee on Workforce, Empowerment and Government Programs
United States House of Representatives

March 18, 2004

Mr. Chairman, Mr. Udall, and distinguished Members of the Subcommittee: Thank you for inviting me to share my views on Health Savings Accounts (HSAs) and HR 3901, a proposal to make private non-group premiums for the high associated with HSAs tax deductible. The views I express are mine alone and should not be attributed to the Urban Institute or any of its sponsors.

I applaud the Subcommittee taking the time to carefully consider the small business implications of the recently enacted HSA provisions and the proposed change to the tax treatment of high deductible insurance policies. Reforms of the health insurance market have potentially important implications for small businesses, which face special challenges in providing health insurance coverage to their workers.

In brief, my main points are:

- Small employers face substantial disadvantages relative to large employers when providing health insurance to their workers. These problems can largely be summarized as higher administrative costs of insurance, limited ability to spread health care risk, and a workforce with lower wages.
- While there are mechanisms available for addressing the problems facing small businesses in the purchase of insurance coverage, HSAs and the policy contained in HR 3901 are not among them.
- The Health Savings Accounts included in the Medicare prescription drug legislation signed into law in 2003 exacerbate the problems faced by small employers and their workers. They increase administrative costs, further segment individuals according to health care risk, and subsidize the highest income purchasers the most.
- The proposal contained in HR 3901 and included in the President's 2005 proposed budget would further complicate the health insurance situation for small businesses and their workers. The proposal provides additional subsidization for higher income people, increases incentives to purchase coverage individually instead of through employer groups, and is likely to decrease access to insurance coverage for high health care cost and low income workers and their dependents.
- On net, HR 3901 may actually decrease insurance coverage. The federal funds necessary to fund this legislation could more effectively be redirected

toward approaches designed to address the explicit problems facing small businesses or to expansion of eligibility in existing State-Children's Health Insurance Programs (S-CHIP) or Medicaid.

I. The Scope of the Health Insurance Problems Facing Small Employers and Their Workers

Only 39 percent of establishments in firms of fewer than 10 workers offer health insurance to any of their workers, compared to 99 percent of establishments in firms of 1000 or more workers (Chart 1).[1]

Approximately 46 percent of workers employed by firms with fewer than 10 workers are offered and are eligible for enrollment in their own employer's health insurance plan, compared to 87 percent of workers employed in firms of 500 or more workers (Chart 2).[2] Workers in the smallest firms are also less likely than their large firm counterparts to take-up employer offers when they have one, although some of these workers receive coverage through a spouse employed by a larger firm (Chart 3).[3]

The lower rates of offer and take-up among small firms and their workers results in roughly 29 percent of workers in the smallest firms being uninsured, while only 9 percent of workers in the largest firms lack coverage (Chart 4).[4]

These lower rates of coverage among small employers are due, at least in part, to the fact that small employers must pay significantly more for the same health benefits than do large employers. Smaller firms face much larger administrative costs per unit of benefit.[5] Administrative economies of scale occur because the costs of administering enrollment and other activities by plans and providers are largely fixed costs.[6] Small firms simply have fewer workers over which to spread these fixed costs. In addition, insurers charge higher risk premiums to small

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[1] Published tables, 2001 Medical Expenditure Panel Survey – Insurance Component, http://www.meps.ahrq.gov/MEPSDATA/ic/2001/Tables_I/TIA2.pdf
[2] Urban Institute tabulations of a merged file of the 2001 February and March Current Population Surveys.
[3] Urban Institute tabulations of a merged file of the 2001 February and March Current Population Surveys.
[4] Urban Institute tabulations of a merged file of the 2001 February and March Current Population Surveys.
[5] Congressional Research Service. 1988. *Costs and Effects of Extending Health Insurance Coverage*. Washington, DC: U.S. Government Printing Office.
[6] Blumberg, Linda J. and Len M. Nichols. 2004. "Why Are So Many Americans Uninsured?" *Health Policy and the Uninsured*, Catherine G. McLaughlin, ed. Washington, DC: Urban Institute Press.

employers, because small employers experience greater year to year variability in medical expenses than do large firms,[7] simply because there are fewer workers over which to spread risk.

Another barrier to small employers providing health insurance is that the average worker in a small firm is paid significantly less than workers in large firms.[8] Economists believe that there is an implicit tradeoff between cash wages and health insurance benefits.[9] In other words, workers actually pay for the cost of their employers' contributions to their health insurance by receiving wages below what they would have received had no employer health insurance been offered. The lower wages of small firm workers imply that they are far less able to afford to pay for health insurance through wage reductions; consequently, their employers are less likely to offer them such benefits.

The fact that small employers must pay a higher premium for the same benefits offered by a large employer makes it difficult for them to compete with large firms for the same workers. Small firms with predominantly low wage workers will have difficulty financing insurance coverage regardless. Any reforms to the health insurance market should be focused on making it easier for small employers to provide health insurance coverage to their workers rather than undermining the efforts of those employers who do provide it.

II. Possible Approaches for Addressing the Insurance Problems of Small Employers

A number of mechanisms can be used for addressing the problems facing small employers in the provision of health insurance to their workers. Some are strategies that apply to reducing the problem of the uninsured in general, and some are of particular interest to small employers and their workers. While options for comprehensive expansions of coverage have been discussed extensively elsewhere,[10] I focus my comments here on incremental types of reforms that deal explicitly with the small business problems of high

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[7] Cutler, David. 1994. "Market Failure in Small Group Health Insurance." Working Paper No. 4879. Cambridge, MA: National Bureau of Economic Research, Inc.
[8] Nichols, Len M., Linda J. Blumberg, Gregory P. Acs, Cori E. Uccello, and Jill A. Marsteller. 1997. *Small Employers: Their Diversity and Health Insurance*. Washington, DC: The Urban Institute.
[9] Blumberg, Linda J. 1999. "Who Pays for Employer Sponsored Health Insurance? Evidence and Policy Implications," *Health Affairs*, vol. 18.
[10] Meyer, Jack A., Elliot Wicks. June 2001. *Covering America: Real Remedies for the Uninsured.* Economic and Social Research Institute.

administrative loads, limited ability to spread health care risk, and low relative wages.

Purchasing Groups. Allowing small firms to band together for purposes of purchasing health insurance has some potential for lowering their administrative cost loads. This has been the motivation of a number of purchasing pools that have been set up in various states.[11] These purchasing pools often provide the side benefit of making it more feasible for small employers to offer their workers a choice of health insurance plans. Instead of shopping for plans independently, small employers pay premiums to the purchasing pool on behalf of their workers, and the pool performs the administrative functions of plan choice, premium negotiation, enrollment, etc. Ideally, the insurance plans interact with the pool's administrator instead of each of the member firms, with marketing and screening activities perform more centrally.

While small employer purchasing pools have met with success in some cases, realizing the efficiencies of large scale purchasing has been difficult for a number of reasons. Chief among them has been the limited ability to reduce the role and inherent expense of insurance agents in the process.[12] So while purchasing pools such as these do have potential to lower the administrative loads for small group purchasers, these savings are more difficult to capture in practice than has been presumed.

It is important to note that purchasing pools such as those described here do not include the legislatively proposed entities known as association health plans (AHPs).[13] The implications of AHPs are altogether different in that they are designed to allow particular multi-employer purchasing entities to avoid compliance with state health insurance regulations. As a consequence of the AHPs' ability to limit membership to select groups and to have their premiums determined separately from the traditional commercial insurance market, they are

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[11] Directory of Consumer-Choice Health Purchasing Groups compiled by the Institute for Health Policy Solutions, http://ihps.org/.

[12] Garnick, Deborah W., Katherine Swartz, and Kathleen Skwara. March/April 1998. "Insurance Agents: Ignored Players in Health Insurance Reform," *Health Affairs*, 17(2): 137-143.

[13] Kofman, Mila and Karl Polzer. January 2004. "What Would Association Health Plans Mean for California?: Full Report." Prepared for the California HealthCare Foundation. http://www.chcf.org/documents/insurance/AHPFullReport.pdf.

largely a tool for segmenting health care risk rather than a tool of generating economies of scale.[14]

Subsidization of Insurance Coverage for High Risk Individuals. Insurers and others recognize that small employers are not large enough for their annual average health expenditures to reflect the average of the insured population as a whole, nor are they large enough to be stable from year to year. Even a single seriously ill worker or dependent enrolled in a small group insurance policy can have tremendous effects on the average expenses of the group in a particular year, whereas a small number of high cost cases in a large group would not substantially affect the group average. As a consequence, insurers charge small employers risk premiums to take into account such unpredictable but potentially extreme fluctuations. Unfortunately, regulatory reforms implemented thus far have been unable to sufficiently spread these risks. State insurance regulations passed throughout the past decade served only to spread the risks within the small group insured population itself. The consequences of this limited risk spreading were increased premium prices for healthy insureds simultaneous with decreased prices for the sick. This forced risk pooling within the small group market led generally to no net change in the number insured as the probability of insurance fell for the healthy and rose for the sick.[15]

Clearly, the small group market itself is too narrow a population over which to spread the costs of high risk individuals. But other risk spreading mechanisms could work much more effectively. For example, many states have established high risk pools. These pools are generally available to individuals who have been refused insurance coverage in the private market, and who do not have offers of employer-sponsored insurance. However, due to the limited public funding through state sources (frequently premium taxes on private insurance policies), these pools may have enrollment caps and usually charge premiums that are well in excess of standard policies in the private market.[16] Some high risk pools offer very limited benefit packages and maintain pre-existing condition exclusion periods. All of these limitations hamper their effectiveness in absorbing

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[14] Blumberg, Linda J. and Yu-Chu Shen. January 2004. "The Effects of Introducing Federally Licensed Association Health Plans in California: A Quantitative Analysis". Prepared for the California HealthCare Foundation. http://www.chcf.org/documents/insurance/AHPBlumberg.pdf.
[15] Nichols, Len M. 2000. "State Regulation: What Have We Learned So Far?" *Journal of Health Politics, Policy, and Law*. 25(1): 175-96.
[16] Chollet, Deborah. October 23, 2002. "Perspective: Expanding Individual Health Insurance Coverage: Are High Risk Pools the Answer?" *Health Affairs* Web Exclusive.

risk from the private market. However, broadening the base for financing these pools, loosening eligibility criteria for enrollment, making the insurance policies themselves more comprehensive, and offering income-related premiums have the potential to make these high risk pools powerful escape valves for the high cost in the small group insurance market.[17] Allowing small employers to buy their high risk workers into well-funded high risk pools would decrease the level and variability in the expenditures of the remaining small group workers and consequently would lower their premiums. The cost of subsidizing the medical care of the high risk could be spread across the entire population, using a broad based tax.

Similarly, the federal government could take on the roll of public re-insurer. In this capacity, the government could agree to absorb a percentage of the costs of high cost cases, once a threshold level of health expenditures had been reached.[18] The distribution of health expenditures is highly skewed, meaning that a large share of total health expenditures is attributable to a small fraction of the population.[19] Ten percent of any insured population typically accounts for 70 percent of all spending by that group. Consequently, financing the relatively small number of very high cost cases publicly can have a substantial impact on the liability of insurers, and by extension, on the premiums charged to small employers.

Another proposal presented in the health reform literature would combine the concepts of purchasing pools for administrative efficiency with explicit subsidization of the high cost and low income.[20] This proposal allows groups wishing to purchase insurance coverage in existing markets under existing insurance rules to continue to do so. However, it would provide structured insurance purchasing pools in each state in which employers and individuals could enroll in private health insurance plans at premiums that reflect the average cost of all insured persons in the state. Broad-based government

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[17] Blumberg, Linda J. and Len Nichols. Fall 1996. "First, Do No Harm: Developing Health Insurance Market Reform Packages," *Health Affairs*.
[18] Swartz, Katherine. May 2003. "Reducing Risk to Increase Access to Health Insurance," *Health Affairs*.
[19] Berk, Marc L and Alan Monheit. March/April 2001. "The Concentration of Health Care Expenditures, Revisited," *Health Affairs. 20(2): 204-213.*
[20] Holahan, John, Len Nichols, and Linda Blumberg, June 2001. "Expanding Health Insurance Coverage: A New Federal/State Approach," *Covering America: Real Remedies for the Uninsured.* Jack Meyer and Elliot Wicks, eds., Economic and Social Research Institute.

funding sources would compensate insurers for the difference between the cost of actual enrollees and the statewide average cost.

Subsidization of Insurance Coverage for Low-Income Individuals. Extensive research has demonstrated that low income individuals are less likely to have health insurance than their higher income counterparts. The same holds true for workers in small firms. Chart 5 shows that rates of uninsurance among workers in small firms (fewer than 25 workers) drop precipitously with income.[21] Fifty-six percent of small firm workers with family incomes below the federal poverty line are uninsured, compared to less than 10 percent of small firm workers with family incomes of 700 percent of poverty or more. Analysis has also shown that higher income individuals are significantly more likely to take-up an employer offer of health insurance than are lower income workers.[22] In addition, there is evidence that low income workers' decisions to take-up health insurance offers from their employers are more responsive to out-of-pocket premium price than are the decisions of higher income workers.

The average wage of workers in the smallest firms (fewer than 10 workers) is roughly 48 percent of that of workers in the largest firms (500 workers or more).[23] This information taken, together with the analyses described above, suggests that affordability of health insurance is a significant barrier to coverage for many small firm workers. Consequently, income-related subsidization of insurance coverage should be strongly considered in any effort to significantly expand coverage within this population.

III. Implications of Health Savings Accounts (HSAs)

The HSA provisions in the Medicare prescription drug legislation passed last year provide a generous tax incentive for certain individuals to seek out high deductible health insurance policies. The minimum annual deductibles are $1,000 for single and $2,000 for family policies. Individuals (and families) buying these policies either through their employers or independently in the private non-group insurance market can make tax-deductible contributions capped at the

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[21] Urban Institute tabulations of a merged file of the 2001 February and March Current Population Surveys.

[22] Blumberg, Linda J., Len Nichols, and Jessica Banthin. "Worker Decisions to Purchase Health Insurance," *International Journal of Health Care Finance and Economics*. vol. 1, p. 305-325, 2001.

[23] Urban Institute tabulations of a merged file of the 2001 February and March Current Population Surveys.

amount of the insurance plan's deductible, up to $2,600 per year in an HSA ($5,150 for a family). Annual contributions are capped at the amount of the annual deductible for the plan in which the individual or family is enrolled. Money in the account and any earnings are tax-free if used to cover medical costs.

For the small percentage of employers who were already offering high deductible policies to their workers, the HSAs allow them to provide an additional benefit to their workers. Under the new legislation, workers can contribute their own funds to the accounts on a tax preferred basis, even if their employer does not make contributions.

These accounts are most attractive to high income people, and those with low expected health expenses. The tax subsidy is greatest for those in the highest marginal tax bracket and is of little or no value at all to those who do not owe income tax. Higher income individuals are also better able to cover the costs of a high deductible, should significant medical expenses be incurred. A $5,150 HSA contribution, the maximum permitted under the law, would generate a tax reduction of $1,802 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. And it would be worth much less that that if the family could not afford to contribute very much into the account.

Additionally, those who do not expect to have much in the way of health expenses will be attracted to HSAs by the ability to accrue funds tax free that they can use for a broad array of health related expenses that are not reimbursable by insurance (e.g., non-prescription medications, eyeglasses, cosmetic surgery). Those without substantial health care needs may also be attracted to HSAs because they can be effectively used as an additional IRA, with no penalty applied if the funds are spent for non-health related purposes after age 65. Young, healthy individuals may even choose to use employer contributions to their HSAs for current non-health related expenses, after paying a 10 percent penalty and income taxes on the funds; a perk unavailable to those enrolled in traditional comprehensive insurance plans.

Moving individuals into higher deductible policies actually increases the share of premiums attributable to administrative costs. The administrative "load" charged by insurers is simply the total administrative costs divided by the total benefits paid. So a 15 percent administrative load implies that administrative costs are

equal to 15 percent of benefits paid out. Because many administrative costs are fixed, lowering the actuarial value of the benefits requires the insurers to increase the administrative load. Consequently, a larger share of premiums paid for high deductible policies will be attributable to administrative charges than when comprehensive coverage is purchased.

The idea of lower premiums under high deductible policies also make these recent reforms attractive to some employer purchasers. However, the savings can only be modest for a fixed group of enrollees. The limited ability of high deductibles to reduce premiums is rooted in the skewed distribution of health expenses. Because the majority of spending is attributable to the small share of individuals with very large medical expenses, increasing deductibles even to $1,000 or $2,000 from currently typical levels will not decrease premiums dollar for dollar. The vast majority of medical spending still will occur above even those higher deductibles. And because premium savings can only be modest, the price effect of moving to higher deductible plans cannot go far in encouraging more employers to offer insurance or more individuals to take it up.

The real premium savings from HSAs can occur by altering the mix of individuals who purchase coverage. By providing incentives for healthy individuals and groups to purchase HSAs with high deductible policies, insurance risk pools can be further segmented by health status. The average medical costs of those purchasing the new plans will be substantially lower if the high risk population is left in more traditional comprehensive plans. The practical effect, however, is that the most vulnerable populations (the sick and the low income) are left bearing a greater burden of their health expenses. The extent to which this is a preferred societal outcome should be explicitly debated.

HSAs will exacerbate all of the existing problems facing small employers. They will lead to higher administrative loads, both for small firms and individuals, further degrade risk pools, and provide the largest subsidies to high income people.

IV. Implications of Tax-Deductibility for Individually Purchased High-Deductible Policies (HR 3901)

HR 3901, consistent with the proposal included in the President's fiscal year 2005 budget,[24] would make the premiums associated with individually purchased high deductible health insurance plans deductible from income taxation. The definition of "high deductible" is the same as that used in the legislation describing HSAs, a minimum of $1,000 for a single and $2,000 for a family policy. The deduction would be allowed regardless of whether other itemized deductions are taken.

This proposal to allow individuals to deduct premiums for policies purchased with HSAs would further complicate matters for small businesses. The tax subsidy would be worth most to those who least need assistance. More importantly, it would undermine the small employer market in key ways. This new proposal increases the incentive for individuals to purchase health insurance in the private non-group insurance market, as opposed to acquiring it through employers. Making the private non-group market more attractive may lead to a decline in the availability of coverage available through small firms.

The proposal would provide a non-group insurance product whose tax advantage is almost as great as that available in the group market and which is most attractive to those with high incomes and low health care risk. Low cost/high-income purchasers, armed with yet another subsidy, would be likely to find price advantages in the non-group insurance market, since most states allow non-group insurers to charge lower premiums for those in good health and to completely exclude from coverage those with current or past health problems. But as low cost purchasers leave the group market, the average cost of those staying in the group market will rise, making group insurance more difficult to afford for higher risk and low income populations. In addition, since employers and key employees will be able to get tax breaks for their high-deductible health insurance even if they do not provide it to their other employees, there will be even less incentive for them to take on the hassle, expense, and risk of offering

[24] "General Explanations of the Administration's Fiscal Year 2005 Revenue Proposals." Department of the Treasury, February 2004. http://www.treas.gov/offices/tax-policy/library/bluebk04.pdf.

insurance to their workers. The net result could be *less* insurance coverage among small businesses.

While the risk pooling available to small firms is low compared to large firms, they are still afforded a greater degree of pooling than is the case in most states' non-group markets. Administrative costs in the non-group market are also even higher than for small firm purchasers. Consequently, those with high costs and low incomes have the most to lose if coverage shifts from the small group to the non-group market.

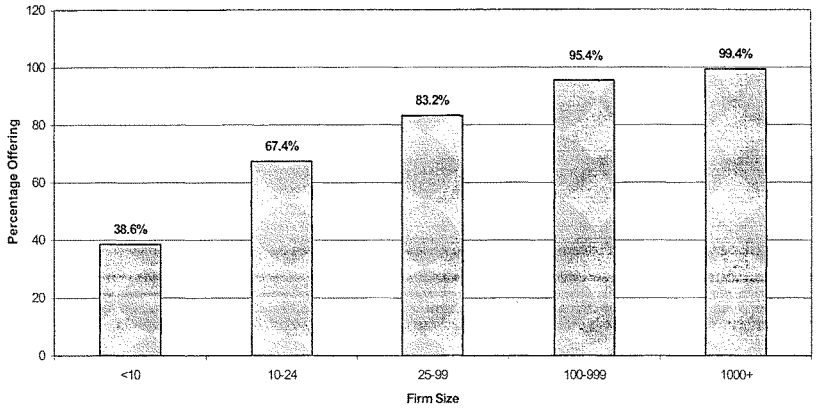
Some will support making these high deductible policies tax deductible from the standpoint of increasing tax equity relative to current law. However, while the bill would put individually purchased high deductible plans on more equal footing with employer purchased plans, it would create new inequities in the private non-group insurance market. The bill would bias incentives for individuals to purchase high deductible policies relative to more comprehensive policies in the non-group market. This new distortion would have the practical effect of further segmenting the non-group insurance market, with high income purchasers even more likely to be drawn out of comprehensive policies. And because health status is highly correlated with income, this would also likely have the effect of segmenting the market further by health status. When creating policy affecting health insurance markets, a single-minded pursuit of tax equity risks ignoring what should be of paramount concern: the impacts on insurance risk pools.

V. Conclusion

While small businesses face formidable difficulties in providing affordable health insurance to their workers, tools are available for increasing coverage in this sector. The focus of such efforts should be on lowering administrative burdens, developing mechanisms for spreading the risk of high cost cases more broadly, and subsidizing low income workers. Reforms intended to expand coverage to small firm workers and their dependents should be evaluated in terms of these goals.

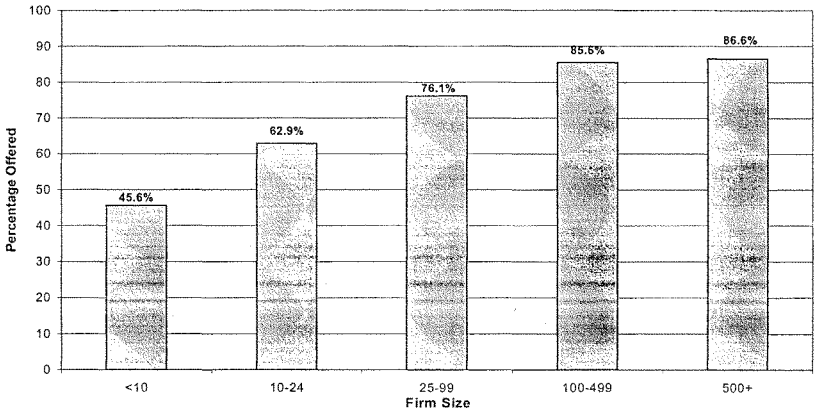
The Treasury Department estimates that allowing deductibility for individually purchased high deductible health insurance would reduce federal revenues by $25 billion over the next ten years, even though the net result could be a reduction in coverage. Funding approaches designed to explicitly address the problems faced by small employers would be federal money better spent.

Chart 1: Share of Establishments Offering Health Insurance, by Firm Size



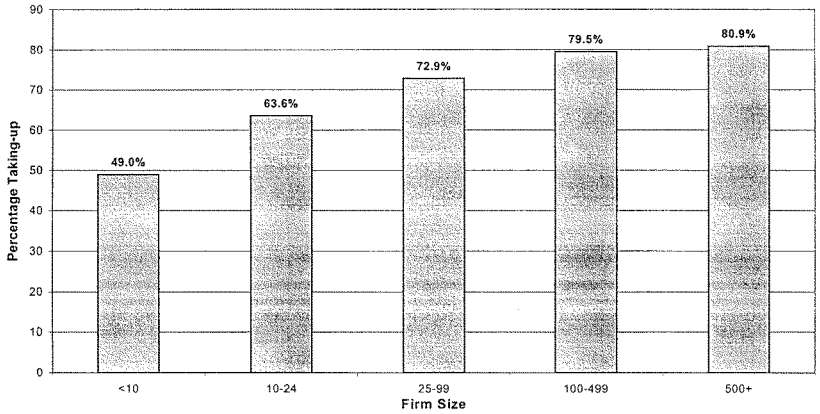
Source: 2001 Medical Expenditure Panel Survey-Insurance Component

Chart 2: Share of Workers Offered Employer-Sponsored Health Insurance, by Firm Size



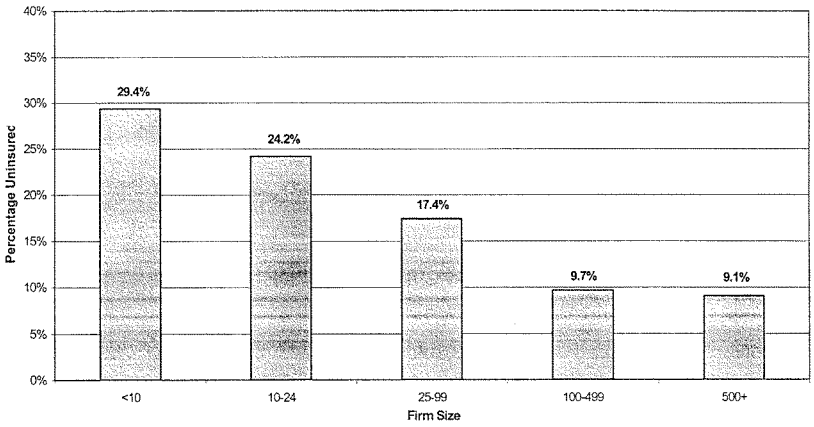
Source: Urban Institute tabulations of a merged file of the 2001 February and March Current Population

Chart 3: Share of Workers Taking-up Own Employer Offer, by Firm Size



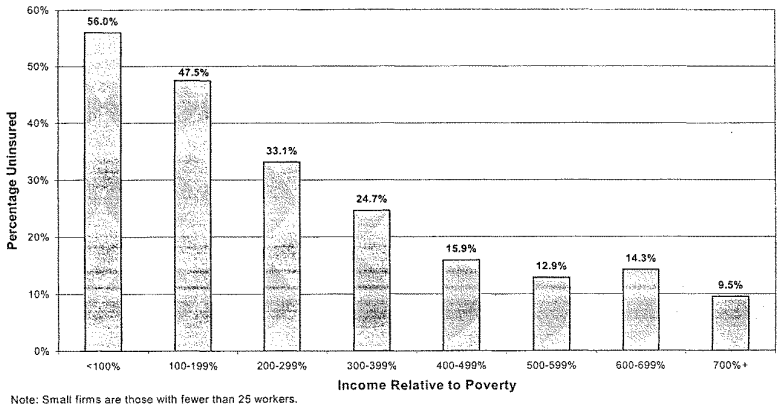
Source: Urban Institute tabulations of a merged file of the 2001 February and March Current Population

Chart 4: Share of Workers Uninsured, by Firm Size



Source: Urban Institute tabulations of a merged file of the 2001 February and March Current Population Surveys.

Chart 5: Uninsurance Rates of Workers in Small Firms, by Income Relative to Poverty



Note: Small firms are those with fewer than 25 workers.
Source: Urban Institute tabulations of a merged file of the 2001 February ad March Current Population