Health Reform Bill Revised:

Can HSAs With HDHPs Save Obamacare?

As you all know, this has been a historical year for health care. Until recently, the United States was the only affluent and industrialized nation not to offer and require comprehensive health care to all our citizens. But on March 23rd 2010 the Obama Administration and congress passed the Health Care Reform Bill extending insurance coverage to 95% of the population[1]. This is the most far reaching proposal to impact the health care market since Lyndon B. Johnson signed the Medicare Bill in 1965.

In short, President Obama's reform package will potentially expand coverage to 32 million presently uninsured Americans by establishing Health-Insurance Exchanges also called state based exchanges– where individuals who earn between 100% and 400% of the Federal Poverty Line can purchase subsidized health insurance from a competitive pool of private insurers.[2]

Individuals earning over $200,000, Couples earning over $250,000, insurers of employee sponsored health plans, employees of the health care industry, tanning salon owners and current and future Medicare recipients will bear the brunt of the expenses to enact this Government entitlement program either through high excise taxes or billion dollar Medicare cuts[3]. No one said health reform that extends coverage to millions would be cheap, but

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[1] Jackson, Jill and John Nolen. "Health Care Reform Bill Summary: A look at What's in the Bill." CBS.news. March 2010. < http://www.cbsnews.com/8301-503544_162-20000846-503544.html>.
[2] Ibid.
[3] Ibid.

saddling a small sector of the population with the majority of this $940 billion[4] operation represents a substantial burden.

Real cost containment methods need to be enacted within the current framework to ensure that this program will not only expand insurance coverage, but grow the economy as well. The first step should be an expansion of Health Savings Accounts with a High Deductible Health Plan into the state-based exchanges to introduce free market forces into the system and reduce health care expenditure in the United States.

Health Insurance is a way for people to collectively pool the risk of incurring ruinous medical expenses. The nature of insurance companies is to charge costumers the expected loss of insurance. This means that in any given year the people who don't use their insurance will pay for other sick people's care. This is a sensible investment for some but for other relatively healthy individuals it simply makes more sense to opt out of health insurance completely. According to an article written by Daniel Polsky, Rebecca Stein and Sean Nicholson, 20% of uninsured Americans were offered health care by their employer but declined getting it.[5] They would rather pose a slight risk of serious injury or illness than to pay high monthly premiums and copayments for unutilized care. Health care would be more widely accepted and cheaper if

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[4] Jackson, Jill and John Nolen. "Health Care Reform Bill Summary: A look at What's in the Bill."

[5] Polsky, Daniel, Rebecca Stein and Sean Nicholson. "Employer Health Insurance Offerings and Employee Enrollment Decisions." HSR: Health Services Research. Vol.40, Number 5. October 2005: 1259-1278. Print.

insurance companies only offered catastrophic medical coverage and left all other payments to the consumer.

Fortunately, High Deductible Health Plans or HDHPs are designed to do exactly that. Consumers are responsible for paying all medical expenses up to the deductible at which point insurance kicks in to cover 100 percent of costs. Potentially the largest advantage of this method is price transparency. Since the first Health Maintenance Organization was established in 1929,[6] consumers have become increasingly unaware of their health care spending. The marginal price of health care has remained concealed because health care packages are priced according to risk. Holders of High Deductible accounts are obligated to factor price into their medical acquisitions because they are the sole payer of their health care up to a certain high deductible. The majority of the market for health care complies with the cardinal rule of economics: demand is downward sloping. Consumers would be inclined to purchase less medical care if they were cognizant of higher prices. In the words of Milton Friedman,"the price that people are willing to pay for products determines what is produced, the cheapest way to produce these things, and how much each person has to spend on the market."[7] Nearly every other market in the United States operates in this way except health care.

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[6] "Florida HMO Plans." East Coast Health Insurance. April 2010. <http://echealthinsurance.com/florida-health-insurance/health101/florida-health-insurance-plan-types/florida-hmo/>.

[7] Friedman, Milton. "Power of the Market- Prices." <http://www.youtube.com/watch?v=7V9ihC1o7wc&feature=PlayList&p=C508C05C017CEC8E&index=2>.

Decades of disobeying the law of supply and demand have helped to fuel the exorbitant costs that are currently plaguing the system.

Although High Deductible Health Plans will revive free market forces, they will do so by generating a rather large donut hole. A donut hole is the amount of medical expenses that would hypothetically not be covered if consumers switched to a self-pay system. Prior to purchasing the High Deductible Health Plan the person needs to be sure that he will be able to afford medical expenses up to the deductible. The solution to this problem is Health Savings Accounts.

A Health Savings Account or an HSA is a tax-free medical savings account that is individually owned and available to any American with qualified health insurance.[8] Unlike other traditional health plans, the individual owns the account and determines the cost of her health care. The money that is not spent on qualified medical expenses rolls over year after year beyond age 65.[9] A study done in 2006 revealed that a Standard Family Insurance Plan saved over $1,600 annually by switching to an HSA plan.[10] Health Savings Account should be sold with a High Deductible Health Plan to encourage the growth of a sizeable medical nest egg. This way, the account holder incurs little to no out-of-pocket costs and is protected from catastrophic medical expenses since she is using her Health Savings Account to pay for low medical expenditures up to the high deductible. High

[8] Rooney, Patrick and Dan Perrin. America's Health Care Crisis Solved. Hoboken, New Jersey: John Wiley & Sons, Inc. 2008.
[9] Rooney, Patrick and Dan Perrin. America's Health Care Crisis Solved
[10] Rooney, Patrick and Dan Perrin. America's Health Care Crisis Solved

Deductibles also yield low premiums that will attract many future participants in the exchange markets such as the uninsured, the self-employed and the individuals and families who earn between 100% and 400% of the FPL.[11] In four years when all Americans are forced to purchase health care, the majority of these low to middle income citizens will be looking for the least expensive form of coverage. Although some argue that that the price elasticity across insurance plans is zero,[12] research strongly suggests that the future clientele of this market would favor the low premiums offered in an Health Savings Account with a High Deductible Health Plan over other traditional plans. In that case, price elasticity across insurance plans would be significant if private insurers competing in the state market were required to offer a Health Savings Account with a High Deductible Health Plan.

A graph posted by the Agency for Healthcare Research and Quality (AHRQ) reveals that 33% of total health care expenditures, or the expenses that are between $664 and $6,444, would fall into the donut hole if consumers purchased this plan. Newfound research strongly suggests that expenses in this donut hole can be reduced if people are simply made responsible for their health care spending.

A recent study by National Bureau of Economics Researcher and Yale Professor Amanda Kowalski proves that the price elasticity of the demand for

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[11] Jackson, Jill and John Nolen. "Health Care Reform Bill Summary: A look at What's in the Bill."

[12] Polsky, Daniel, Rebecca Stein and Sean Nicholson. "Employer Health Insurance Offerings and Employee Enrollment Decisions." HSR: Health Services Research. Vol.40, Number 5. October 2005: 1259-1278. Print.

health care from the 65th percentile to the 95th percentile of health care expenditures is - 2.3%.[13] By looking at Kowalski's summary table, we see that the 33% of health care expenditures that would theoretically comprise the donut hole perfectly fit into her quantile range. This means that a 1% increase in price would decrease health care expenditures in the donut hole by 2.3 percent! Consumers are much more responsive to prices in health care than previously presumed which

emphasizes the importance of making prices transparent. If we believe that the marginal effect of a price increase can dramatically reduce consumer spending, then it makes sense to implement Health Savings Accounts with High Deductible Health Plans into the state based insurance market.

[13] Kowalski, Amanda E. "Censored Quantile Instrumental Variable Estimates of the Price Elasticity of Expenditure on Medical Care." National Bureau of Economic Research. June 2009. March 2010. < http://www.nber.org/tmp/69935-w15085.pdf>.

Percent Reduction of health care expenditures	Percent Reduction of Total Health Care Expenditures	Percent Reduction as Part of GDP	Percent Health Care Expenditure as Part of GDP Post-Reduction
5	1.7	0.26	15.7
10	3.3	0.53	15.5
20	6.6	1.1	14.9
30	9.9	1.6	14.4

Table 1: Reduction in Total Health Care Expenditure as a Result of Price Transparency

Here are various calculations that show how reductions in health care expenditures that would fall into the donut hole would affect total health care expenses as a part of GDP. The outcome that actualizes depends on a couple of factors. This first is how many people would purchase this plan and the second is how the -2.3% demand for health care elasticity would translate into consumer behavior. Right now health care expenditure as a part of GDP is 16%. If we reduce expenditures in the donut hole by 5% we could reduce total health care expenditure by 1.7%. In relative terms, that would decrease health care expenditure as a part of GDP by .26% making it 15.7% instead of 16%. If we reduce health care expenditures in the donut hole by 30% we could reduce total health care expenditure by 9.9%, which would reduce health care as a part of GDP by 1.6% making it 14.4%! Undoubtedly these reductions are significant but some wonder if they are significant enough to outweigh the possible disadvantages of Health Savings Accounts.

Realistically, enrollees in the state-based exchange markets who purchase this health plan will be burdened with perilous tradeoffs: Should you forgo the doctor appointment today just to end up in the emergency room tomorrow? The consumer is the purchaser of health care up to the deductible, which will require the enrollee, instead of the insurer, to make a series of decisions to best fit his medical needs. Opponents also argue that this plan would only benefit young or healthy individuals but we have already proven that is it is advantageous for low to middle income clients and self employed persons as well. Ultimately, if enacted this policy would change the way health care is perceived in America. Many of you are probably wondering is it worth the risk? And the answer is yes- a low cost plan that will appeal to many and significantly reduce health care expenditure is definitely worth pursuing.

CEO of Whole Foods John Mackey exemplifies this point by saying that the combination of High Deductible Health Plans and Health Savings Accounts is one solution that could solve many of our health-care problems. Mackey offers this plan to 89% of Whole Foods employees and says that it has much lower costs than typical health insurance and provides a very high degree of worker satisfaction.

In conclusion, although the integration of a Health Savings Account with a High Deductible Health Plan will not cure America's health care problem, it will lead to a more cost controlled medical network. Once this Bill is enacted, the previously uninsured and self-employed persons will be looking for a plan that satisfies the bare minimum number of requirements at the lowest cost: i.e. the McDonald's of health insurance. The exchange market can accommodate the needs of the masses with the implementation of Health Savings Accounts with a High Deductible Health Plan. In addition to satisfying consumer demand, this plan will also substantially reduce health care expenditures in the donut hole by compelling costumers to be mindful of their medical spending. The American health care market needs to restore the basic supply and demand model within the government health care program to decrease costs while expanding coverage. Health Savings Accounts with a High Deductible Health Plan will lay the foundation of a cost effective health care market for generations to come.

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