

A Roth Health Savings Account can help families meet the burden of medical expenses with tax-free withdrawals.

## Roth Health Savings Accounts

Here are four pieces of bad news: Even though (1) the Obamacare out-of-pocket limits are outrageously high, (2) 80 percent of exchange plans are incompatible with a Health Savings Account, (3) new regulations will virtually outlaw HSAs for the remaining 20 percent, and (4) the Obama administration has no clue about how to merge health savings with third-party health insurance, even if the desire were there.

Beginning next year, the annual out-of-pocket limits for all health plans sold in the (Obamacare) health insurance exchanges will be \$7,150 for an individual and \$14,300 for a family. To put those numbers in perspective, a \$10-an-hour employee only earns about \$20,000 a year.

One way to help families meet the burden of these medical expenses is with a Health Savings Account. But because the requirements for HSAs are so rigid, roughly four out of five plans sold in the exchanges are incompatible with them. One of the most nettlesome rules is the requirement that HSA plans cover only “preventive care” below the deductible. To compete for customers, especially young healthy enrollees, the insurers believe they need to make more services available with a minimum of out-of-pocket costs.

Things are about to get much worse. New rules and regulations, which become mandatory in 2018, will impose minimum and maximum deductibles and out-of-pocket limits that are inconsistent with the HSA rules. In most cases the differences are only \$50 or \$100. Yet that is enough difference to virtually outlaw HSAs in the exchanges.

Since insurers are required to sell the same plans outside the exchanges that they sell inside, HSAs are destined to disappear from the entire individual market.

Critics contend this is no accident. The Obama administration could easily fix the compatibility problem if it wanted to. But it doesn't seem to have the desire. Strangely, the administration seems to have no interest in helping people save for unexpected medical expenses.

But as long as we are considering “fixes,” the time has come to get the economic incentives right. Trying to merge a traditional HSA with insurance subsidized by tax credit is like trying to put a square peg in a round hole.

Putting money into a savings account is an act of self-insurance. Paying premiums is buying third-party insurance. In an ideal world, we would want public policy to be neutral between these two alternatives. That way, individual choice and competition in the marketplace will determine to what extent people will manage their own health care dollars and to what extent they will surrender those



dollars to a third-party insurer.

For most of our post World War II history, public policy was not neutral. Employers were allowed to pay premiums with pre-tax dollars, but they were not allowed to make pre-tax contributions to a savings account. This tilted the playing field in favor of third-party insurance and encouraged people to give all of their health care dollars to the third-party payers – employers, insurance companies and government. The result: we got too much third-party insurance and too little self-insurance, surely a factor in our tendency to overspend on health care.

Then in 1983, federal legislation leveled the playing field by allowing employers and employees to make pre-tax contributions to HSAs. The self-employed were allowed to deduct contributions to HSAs, just as they were allowed to deduct health insurance premiums.

Obamacare, however, introduced a new way of subsidizing health insurance: the fixed sum tax credit. When people purchase insurance in a health insurance exchange, the first dollars of spending are subsidized. Beyond that, marginal spending on premiums is all after tax. Thus, if we want a level playing field, we need to make sure that marginal deposits to a savings account are also after tax. Otherwise, we will be tilting the field in the opposite direction – encouraging too much self-insurance and too little third-party insurance.

How do we do that? By making sure that the savings account is a Roth account.

With a Roth HSA, there are after-tax deposits, tax-free withdrawals for health purposes (during

the insurance period) and tax-free withdrawals for any purpose (after the insurance period).

Economists like this idea because it gets the incentives right at every margin. The choice between third-party insurance and individual self-insurance, the choice between health care and other goods and services, the choice between current health care and future health care and between future health care and future other goods and services — all these choices are made on a level tax playing field.

Incidentally, the idea of subsidizing health insurance with a tax credit is not just a Democratic idea. For the past 20 years or so, there have been dozens of Republican proposals that also adopted a tax credit approach. Yet none of the sponsors of these proposals seemed to be aware that they were pairing third-party insurance (tax-subsidized one way) with individual self-insurance (tax-subsidized in a different way).

Finally, as long as we are getting the tax incentives right, let's also get the HSA design right. The most important impediment to the growth of HSAs – both inside and outside the exchanges – is that the design required is highly rigid. It makes no economic or insurance sense to require the same deductible for every service. Ideally, the account should be completely flexible, wrapping around any third-party insurance plan — serving as a source of funds for any expense not paid by the third-party insurer.

A version of this document was originally posted by John Goodman at *Forbes*.



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