The Heritage Foundation
LEADERSHIP FOR AMERICA

CENTER FOR
POLICY INNOVATION

HERITAGE'S **"THINK TANK WITHIN A THINK TANK,"** PROMOTING POLICY DISCUSSION AND DEVELOPING BREAKTHROUGH IDEAS

RESEARCH SUMMARY

NO. 3 | JULY 9, 2012

Summaries of critical research and cutting edge proposals by leading policy analysts, scholars, and organizations.

The Promise of Consumer-Directed Health Plans: Studies Show Success at Reducing Costs and Maintaining Quality

Kathryn Nix and Alyene Senger

Abstract

Over the past decade, the use of consumer-directed health plans (CDHPs) has increased substantially. In 2006, Indiana introduced plans with health savings accounts as a coverage option for state employees. A case study by Mercer Health and Benefits LLC, a leading consulting firm, examined the outcome of Indiana's implementation and found generous cost savings and increasing annual enrollment. Another study published in Health Affairs *found that greater use of CDHPs that use HSAs or HRAs could result in annual savings as high as $57 billion in the overall health care system. This body of research highlights the proven success of consumer-directed health plans and their potential to address rising health care costs without sacrificing quality of care.*

This paper, in its entirety, can be found at **http://report.heritage.org/rs-03**

Produced by the Center for Policy Innovation

The Heritage Foundation
214 Massachusetts Avenue, NE
Washington, DC 20002
(202) 546-4400 | heritage.org

Nothing written here is to be construed as necessarily reflecting the views of The Heritage Foundation or as an attempt to aid or hinder the passage of any bill before Congress.

Runaway health care spending is one of the most pressing challenges facing the United States health care system. In 2010, the U.S. spent 17.9 percent of gross domestic product on health care—more than any other nation in the world.[1] A main driver of this spending appears to be that health care consumers have become increasingly insulated from the cost of health care.[2]

The emergence of consumer-directed health plans (CDHPs), which include plans that provide comprehensive coverage by combining a high-deductible health plan (HDHP) with a tax-preferred health savings account (HSA) or an employer health reimbursement arrangement (HRA), offers a promising solution to the problem of how best to achieve more cost-conscious patient decision-making. Since 2003, health plans with HSAs have gained in popularity. According to the data collected from health insurers by the major trade association for health insurance plans, as of January 2012, 13.5 million Americans were enrolled in HSA plans, an 18 percent increase from the 11.4 million enrolled in 2011 and a twofold increase since 2008, when 6.1 million people were enrolled.[3] According to the Kaiser Family Foundation, in 2011, "Eight percent of covered workers are enrolled in HDHP/HRAs and 9% are enrolled in an HSA-qualified HDHP."[4]

These types of CDHPs have become an especially attractive option for employers who offer health care coverage to their workers, since they have significantly lower premiums. Employers are able to make contributions to workers' HSAs or HRAs, which can be used to cover part or all of the employee's deductible and other medical expenses. HSAs can be funded by both employers and employees, and leftover funds in the accounts roll over and belong to the employee. HRAs are funded solely by the employer, and unused funds simply represent money the employer did not have to spend.

CDHPs increase consumer engagement and awareness of the cost of routine health care expenses,

meanwhile providing true protection against catastrophic events. Critics of this approach to reducing health care costs voice concerns that it might reduce access and utilization. However, research shows that these CDHPs are successful at reducing health care costs for both employers and employees, with little evidence of reduced use of necessary care, and could lead to even greater savings if enrollment continues to grow.

Success of CDHPs for Indiana State Employees

A 2010 case study by Mercer Health and Benefits, a leading human resource and financial consulting firm, analyzed the effectiveness of high-deductible plans paired with HSAs at decreasing the cost of state employee coverage for the state of Indiana. In 2006, seeking to reduce health care costs, Indiana Governor Mitch Daniels led the state to become one of the first public entities to offer HSA plans to state employees. The experiment has since been successful at reducing spending for both the state and its employees, and enrollment in the HSA plans has increased dramatically, with 70 percent of all state employees estimated to be enrolled as of 2010.[5]

Before introducing an HSA option, Indiana offered its 30,000 state employees and their families a choice between two preferred provider organizations (PPOs) and two health maintenance organization (HMO) plans. The state introduced the first HSA plan in 2006, alongside the already existing plans. In 2007, a second HSA plan with lower cost-sharing and a smaller state contribution was introduced. In this same year, the two PPOs consolidated into one plan, and one of the HMOs was terminated.

INCREASED RESPONSIBILITY FOR HEALTH SPENDING ENCOURAGED CONSUMERS TO SUBSTITUTE GENERICS FOR BRAND DRUGS, AVOID UNNECESSARY EMERGENCY ROOM VISITS, AND USE PRIMARY-CARE PHYSICIANS INSTEAD OF SPECIALISTS WHEN APPROPRIATE.

Mercer compared the experience with the HSA plans to the remaining PPO and found that the HSA plans led to substantial cost savings. All three plans had comparable actuarial value, but average premiums for the PPO were higher than the premiums for both HSA plans. From 2006–2009, the PPO plan averaged $12,317 in total cost, compared to $5,462 for the HSA plan with the highest deductible and $9,444 for the other. Combined, HSA plans saved the state an average of 10.7 percent over the study period, and the state was projected to have saved an estimated $17 million to $23 million in 2010. Mercer also projected that state employees and their families who enrolled in an HSA plan were estimated to have saved a combined $7 million to $8 million in 2010.[6]

According to the Mercer study, savings for those enrolled in the HSA plans came from reduced utilization and lower intensity of services. The study found no evidence that participants avoided care; to the contrary, migration was “virtually a one-way flow” from the PPO option to the HSA plans, and “[i]f participants were having adverse experiences this would not be the case.” In addition, there was “no reporting over the study period of any such issues of adverse results from deferred care.”[7]

1. Centers for Medicare and Medicaid Services, Office of the Actuary, “National Health Expenditure Projections 2011–2021,” Table 1, “National Health Expenditures and Selected Economic Indicators, Levels and Annual Percent Change: Calendar Years 2006–2021,” http://www.cms.gov/Research-Statistics-Data-and-Systems/Statistics-Trends-and-Reports/NationalHealthExpendData/Downloads/Proj2011PDF.pdf (accessed June 27, 2012).
2. See Centers for Medicare and Medicaid Services, Office of the Actuary, “National Health Expenditures, Historical Tables,” Table 3, “National Health Expenditures, Aggregate, and Average Annual Growth from Previous Year Shown, by Source of Funds, Selected Calendar Years 1960–2010,” http://www.cms.gov/Research-Statistics-Data-and-Systems/Statistics-Trends-and-Reports/NationalHealthExpendData/Downloads/tables.pdf (accessed June 27, 2012). See also Amy Finkelstein, “The Aggregate Effects of Health Insurance: Evidence from the Introduction of Medicare,” *The Quarterly Journal of Economics*, Vol. 122, Issue 1 (February 2007), http://economics.mit.edu/files/788 (accessed June 27, 2012).
3. America’s Health Insurance Plans, Center for Policy and Research, “January 2012 Census Shows 13.5 Million People Covered by Health Savings Account/High-Deductible Health Plans (HSA/HDHPs),” May 2012, http://www.ahip.org/redirect/2012hsacensus.pdf (accessed June 27, 2012).
4. The Kaiser Family Foundation and Health Research and Education Trust, *Employer Health Benefits*, 2011 Annual Survey, p. 5, http://ehbs.kff.org/pdf/2011/8225.pdf (accessed July 9, 2012).
5. Cory Gusland, Tyler Harshey, Nick Schram, and Todd Swim, “Consumer-Driven Health Plan Effectiveness Case Study: State of Indiana,” Mercer Health and Benefits, May 20, 2010, http://www.in.gov/spd/files/CDHP_case_study.pdf (accessed June 27, 2012).
6. Ibid., p. 2.
7. Ibid., p. 13.

Instead, the study concludes, "Sources of savings appear to come from better use of healthcare resources and more cost conscious decision making."[8] Increased responsibility for health spending encouraged consumers to substitute generics for brand drugs, avoid unnecessary emergency room visits, and use primary-care physicians instead of specialists when appropriate. Participants also had lower hospital admissions and shorter lengths of stay when they were admitted.

In just five years, HSA plans produced clear savings in Indiana while increasing in popularity. As Mercer concludes:

> Health care cost can be positively influenced if patients are motivated to be better consumers, empowered with information about provider quality and treatment options, and given access to the tools and support required to understand and improve their health status. Obviously, these individuals and their employers also benefit from improved health status, energy and productivity.[9]

CDHP Expansion Could Lead to Greater Health Care Savings

A separate report shows that expanding enrollment in health plans with HSAs or HRAs in the employer market could significantly reduce the nation's health care spending. Amelia M. Haviland, associate professor of statistics and public policy at Carnegie Mellon University; M. Susan Marquis, senior economist at the RAND Corporation; Roland D. McDevitt, director of health care research at Towers Watson; and Neeraj Sood, director of international programs at the Leonard D. Schaeffer Center for Health Policy and Economics at the University of Southern California, project the system-wide impact if enrollment grew to 50 percent as a share of employer-sponsored insurance.[10]

"REDUCTIONS IN HEALTH CARE COSTS CAUSED BY ENROLLMENT IN CONSUMER-DRIVEN PLANS WERE SIMILAR FOR VULNERABLE AND NONVULNERABLE FAMILIES," WHICH COULD IMPLY THAT FAMILIES WITH HIGHER HEALTH CARE COSTS OR LOWER INCOME DID NOT GO WITHOUT NECESSARY CARE BECAUSE OF HIGHER COSTS.

The authors based their calculations on previous analysis of health insurance claims and survey data from a diverse group of 59 large U.S. employers, which determined the first-year outcomes of high-deductible plans with HSAs and HRAs . Measures of outcomes included total spending, health care use, preventive care, episodes of care, and effects on vulnerable populations.

The authors used the existing first-year outcomes and applied them to population benchmarks in order to calculate the effects of an expansion of HSA and HRA plans on health care costs in the non-elderly, employer-sponsored insurance market. They determined that savings would materialize in the same ways that were observed in Indiana: greater generic substitution, fewer specialist visits, and less frequent hospitalizations.

The study modeled the effect of increasing HSA and HRA plans from their current 13 percent of the employer-sponsored market to 50 percent, which the authors believe is plausible in the coming decade. The result of the projected expansion was an overall reduction in annual health spending of $57 billion, which would amount to a 7 percent reduction in health care spending for the employer-sponsored insurance population and a 4 percent reduction for the non-elderly population as a whole.

Under this scenario, half of the increase was attributed to plans with HSAs and half to plans with HRAs. Due to their structural differences, savings are greater for plans that include HSAs than they are for those paired with HRAs. The study showed that if HSAs were to make up the entire increase, annual savings would reach $73.6 billion, or 9.1 percent of health care spending in employer-sponsored insurance and 5.4 percent of total non-elderly health spending.

According to the authors, "findings that reductions in spending occur through lower spending per episode, more use of generic versus brand-name drugs, less use of specialists, and lower inpatient hospitalization suggest that these plans do induce changes in treatment choices and not just access." Moreover, "in

8. Ibid., p. 3.
9. Ibid., p. 4.
10. Amelia M. Haviland, M. Susan Marquis, Roland D. McDevitt, and Neeraj Sood, "Growth of Consumer-Directed Health Plans to One-Half of All Employer-Sponsored Insurance Could Save $57 Billion Annually," *Health Affairs*, Vol. 31, No. 5 (May 2012), pp. 1009–1015, http://content.healthaffairs.org/content/31/5/1009.full.pdf+html (accessed May 29, 2012).

the first year of enrollment, the reductions in health care costs caused by enrollment in consumer-driven plans were similar for vulnerable and nonvulnerable families," which could imply that families with higher health care costs or lower income did not go without necessary care because of higher costs.

Conclusion

Taken together, this body of research shows that consumer-driven health care options like HSA or HRA health plans have the ability to reduce rising health care costs by giving consumers incentives to make cost-conscious decisions. While HSA or HRA plans may not be the best choice for all patients, some of whom may prefer to pay higher premiums for the kind of coverage provided by more traditional PPO or HMO plans, this research indicates that health reforms that would increase patient choice with regard to options for health insurance and medical care would be a dependable tool for reducing costs without sacrificing quality of care in the health care system.

Summary of Findings

- Consumer-driven health plans offer a way to give consumers greater control of their health care expenses, encouraging more cost-conscious decisions.
- In Indiana, HSA plans have proved to be a popular alternative to traditional forms of coverage for state employees, and enrollment has increased substantially since their introduction in 2006.
- HSA plans have resulted in significant cost savings in Indiana, both for the state as an employer and for state workers. Evidence shows that cost savings have come from changes in behavior and greater consumerism, not from reduced utilization of necessary care.
- Further expanding enrollment in plans with HSAs or HRAs could lead to greater savings for employers, employees, and the nation as a whole.

*—**Kathryn Nix** is a Policy Analyst and **Alyene Senger** is a Research Assistant in the Center for Health Policy Studies at The Heritage Foundation.*