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Health Insurance: Why Rent When You Can Own?

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Most people agree it is better to own than rent. Ownership allows people to build equity and gives them positive incentives to take care of what they possess. The benefits of ownership are well known in the housing market, and federal policymakers are currently discussing whether Americans should own a portion of their Social Security contributions in the same way they own their individual retirement accounts.

Until recently, however, Americans have been unable to practice ownership in health care--perhaps one of the most important areas in their lives. But as of January 1, 2004, approximately 250 million non-elderly Americans, at least in principle, have access to health savings accounts (HSAs) that consumers both own and control.

Few Incentives, Misunderstood

Traditional health insurance is like renting health coverage year after year. Throughout the year, a health insurance purchaser pays monthly premiums to a health plan in return for access to medical care.

Renting a house gives one a right to occupy it only while rent is being paid. Similarly, health insurance purchasers pay only for the right to access medical benefits (should they need them) for a set period of time. They accrue no equity in return for premiums they paid in the past.

A renter has no incentive to shop prudently for home repairs. Nor does the purchaser of health insurance have an incentive to shop prudently for medical services. With traditional health insurance, consuming fewer medical services one year does not increase their availability in future years.

Unused funds do not roll over for use in future periods when health needs may be greater. In many cases, insured patients bear only a fraction of the cost. They pay little, even for taking expensive drugs with scant therapeutic benefits. And they pay little when scheduling unnecessary doctor visits. Consequently, patients have few incentives to be prudent consumers of medical care, since they benefit little from their efforts to save money.

Because 85 percent of medical costs are paid by someone else (specifically, insurers and government), consumers have an incentive to consume medical care until the last dollar spent is worth only 15 cents to them.

Third parties pay most health care costs because a dollar of wages given to an employer-sponsored health plan receives a generous tax subsidy of 45 percent, whereas there is no subsidy for health care dollars paid out-of-pocket with after-tax dollars. Moreover, employer-sponsored health coverage is popular because workers mistakenly assume their employers pay part of the premiums. Economists know otherwise: Workers bear the total cost of their health plans through direct contributions and indirect wage reductions.

Poor Financial Return

I have rented employer-sponsored health insurance for about 15 of the past 19 years. Over the years my health coverage has cost more than $30,000, excluding $1,000 paid for a dental plan that's been in effect for only 24 months.

During the past 19 years I've had medical expenses of about $3,000 and dental expenses of about $5,000. Only about $2,000 of my health and dental bills were covered by insurance. I had to pay $2,000 out-of-pocket for non-covered medical care and about $4,000 in unreimbursed dental care.

In other words, 15 years' worth of health coverage cost around $31,000 (including dental), returned only $2,000 in benefits (including dental), and covered only one-quarter of my medical and dental needs. Moreover, I accrued no equity.

Does that sound like a bargain? One could argue my health coverage also provided a measure of "health security," which should be worth something to me. After all, the only way to "win" at health insurance is to get sick ... and nobody wants to get sick.

But how much is health security really worth? A way to estimate its value is to look at prices of low-cost, high-deductible health coverage. Health plans with high annual deductibles (between $1,500 to $2,500) cover major medical problems but do not pay for day-to-day doctor visits, dental care, or prescription drugs. A good rule of thumb is that high-deductible health plans generally cost about half as much as policies with nominal annual deductibles ($0 to $500 per year).

Based on this estimate, insuring against major medical problems (meaning those unlikely to occur) should have cost me only about $15,000 during the past 19 years.

In addition, if I exclude dental costs and premiums, the $30,000 I paid for health coverage minus $15,000 that high-deductible health plans would have cost, minus $1,000 in covered medical services, leaves about $14,000 in premiums that I could have deposited into an HSA. With interest, I could have accumulated nearly $30,000 in an HSA by now. Accounting for increased health needs, my balance could grow to nearly $100,000 by the time I reach 55.

Fairer, Sensible Alternative

Unfortunately, when I got my first good job 19 years ago, HSAs did not exist. I was only renting coverage year to year. This means I don't have $14,000 (plus $16,000 in accumulated interest) in an HSA I own and control.

So, where did my premiums go? Some was lost to inefficiency and bureaucracy. Another portion went to subsidize coworkers who ran to the doctor every time they had the sniffles--after all, someone else was helping pay their medical bills. But most of my money went to cross-subsidize older (read: wealthier) coworkers who experienced greater health needs as they reached their years of peak earnings approaching retirement.

What this means is that over the next few years, if I lose my job, become disabled, or decide to retire early, I will find health coverage increasingly unaffordable. Should I decide to quit my job to start my own business, I will have no healthy coworkers around to subsidize my medical care at a time when I will increasingly need more services. When I become eligible for Medicare, I will not have a large nest egg to help defray the costs of prescription drugs.

Rather than "renting" coverage year-to-year and having nothing to show for it if they lose their jobs or retire early, Americans would do better to manage their own health care dollars through HSAs they own and control. This would allow families to pool their health risks across their own working lives rather than across arbitrary groups like employer-risk pools.

Consumers can use HSA funds to pay expenses not paid by third-party insurance, including dental work, the cost of out-of-network doctors, and prescription drugs. They can profit from being wise consumers of medical care by having account balances grow, tax-free, and eventually become available for nonmedical purchases.

As in other areas of life, Americans who are currently renting their health coverage should consider the benefits of ownership.

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