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A Simple Way to Control Healthcare Spending

By: John C. Goodman **September 4, 2012**

As I wrote in my recent book, *Priceless: Curing the Healthcare Crisis*, there is something rather simple the federal government could do that would have enormous impact in controlling healthcare costs: Allow deposits to FSAs to roll over at year end and grow tax-free. [1]

Here's the backstory. Like HSAs and HRAs, Flexible Spending Accounts are set up by employers. But unlike those use-it-or-save-it accounts, FSA accounts are use-it-or-lose-it. Any account balance left at year end (or after an extra two and a half-month grace period) is forfeited.

Employers are allowed to make deposits to FSAs, and there is no limit to how much they can deposit, but few take advantage of this opportunity. Because of the use-it-or-lose-it feature, these plans are additions to, rather than integrated parts of, employer health plans. Because the deposits are tax-free, they almost certainly add to healthcare spending, as they are currently structured. They encourage employees to purchase designer eyeglasses with pre-tax dollars, for example, rather than purchase other goods and services with after- tax dollars. At year's end, employees will view almost any kind of permissible spending as preferable to forfeiting the money left in the account.

Why are these accounts use-it-or-lose-it? Apparently this feature is the result of a Treasury Department ruling, not the result of any act of Congress. So I believe the Treasury could undo this unfortunate rule without any new legislation.

What if these accounts could roll over and grow tax-free? Then employers and their employees would have a vehicle much better than any option currently available to them to control healthcare spending:

• FSAs could be combined with high deductibles, allowing employees to directly control, say, the first $2,500 of spending without all of the pointless restrictions that hamper the usefulness of HSAs.

• FSAs could be created to allow employees control of whole areas of spending, say, all preventive care and all diagnostic tests—services for which individual discretion is both possible and desirable.[2]

• FSAs could be created for the chronically ill[3]—allowing, say, diabetics or asthmatics to manage their own healthcare dollars, much as home-bound, disabled Medicaid patients manage their own budgets in the Cash and Counseling Programs.[4]

• FSAs could be combined with value-based purchasing insurance plans[5]—where the insurer pays only for certain drugs, doctors, and hospitals but allows patients to add money out-of-pocket and make

other choices—thus allowing the development of a real market for more expensive healthcare services.[6]

Currently, about 25 million people have an HSA or HRA account (roughly evenly split), and another 35 million people have FSAs. That means that over half the people with a health account have an incentive to spend rather than to save. If FSAs could roll over and become use-it-or-save-it accounts:

• There would be a huge immediate impact on the incentives of the 35 million current account holders if they could save for more valuable future healthcare spending.

• Employers across the country would consider integrating these accounts into their health plans, making employer contributions to them, and experimenting with some of the new health plan designs described here.

• Many of the companies that currently have HSA or HRA plans might discover the FSA approach better for controlling costs.

[1] Michael F. Cannon, "Flexible Spending Accounts: The Case for Reform," National Center for Policy Analysis, Brief Analyses No. 439, May 13, 2003.

[2] John C. Goodman, Gerald L. Musgrave and Devon M. Herrick, "Designing Ideal Health Insurance," in *Lives at Risk: Single Payer National Health Insurance Around the World* (Lanham, MD: Rowman & Littlefield Publishers, 2004), 235.

[3] John C. Goodman, "Ten Small-Scale Reforms for Pre-Existing (Chronic) Conditions," *Health Affairs Blog*, January 27, 2010.

[4] John Goodman, "Patients Managing Their Own Healthcare Budgets," *John Goodman's Health Policy Blog*, April 19, 2010.

[5] Jack A. Meyer, Lise S. Rybowski and Rena Eichler, "Theory and Reality of Value- Based Purchasing: Lessons from the Pioneers," Agency for Healthcare Policy and Research, AHCPR Publication No. 98-0004, November 1997.

[6] Goodman, Musgrave, and Herrick, "Designing Ideal Health Insurance," 235.