NATIONAL CENTER FOR POLICY ANALYSIS

A Brief History of Health Savings Accounts

Brief Analysis No. 791 by Devon Herrick December 9, 2013

In January 2004, 250 million non-elderly Americans gained access in principle to health savings accounts (HSAs). Since then, individuals have been able to self-insure for some of their own medical needs and manage some of their own health care dollars.

Dallas Headquarters:
12770 Coit Road, Suite 800
Dallas, TX 75251
972.386.6272

www.ncpa.org

Washington Office:
601 Pennsylvania Avenue NW,
Suite 900, South Building
Washington, DC 20004
202.220.3082

Origins. Apparently, the idea of health savings accounts was independently conceived by many people. After the concept was introduced to the NCPA by Senior Fellow Jesse Hixson, the American Medical Association's chief economist for many years, NCPA President John Goodman and Senior Fellow Gerald Musgrave developed it through many publications. As a spokesman for the idea, Goodman was called the "Father of Medical Savings Accounts" by House Ways & Means Committee Chairman Bill Archer and the *Wall Street Journal*. More recently, the *National Journal* called him the "Father of HSAs."

Though HSAs might not exist today without the NCPA's work, other groups also made important contributions — including the Council for Affordable Health Insurance (CAHI), the MSA Coalition and the American Legislative Exchange Council (ALEC).

Early History. In January 1984, the NCPA published a plan to use individually owned "medical IRAs" to solve the long-term problem of Medicare. Two months later, Goodman and Richard Rahn, then chief economist for the U.S. Chamber of Commerce, outlined this plan in a *Wall Street Journal* article. That same year Singapore introduced a mandatory "Medisave" program.

Goodman and Musgrave wrote a seminal study documenting opportunities in the United States to select high-deductible health insurance and place the premium savings in a personal health account to pay for small medical expenses. A follow-up study contrasted MSAs and managed care. A *Health Affairs* article by Goodman and Wharton School economist Mark Pauly showed how the tax system could encourage health insurance without distorting health care choices through the use of Roth-type medical savings accounts.

Patient Power. In 1990, the NCPA organized a task force of researchers from 40 think tanks, universities and research organizations, including the American Enterprise Institute, the Cato Institute and the Hoover Institution. The report advocated self-insurance for small medical bills through "medisave" accounts — a concept thereafter called medical savings accounts (MSAs). Goodman and Musgrave expanded the work of the Task Force into a classic book, *Patient Power*, published by the Cato Institute in 1992.

Capitol Hill responded quickly. In 1992, 12 different bills designed to create medical savings accounts received the bipartisan support of 150 congressional cosponsors, including both conservatives and liberals. For example, S. 2873 was introduced in June 1992 by Sen. John Breaux and 12 cosponsors, including Democratic Senators Thomas Daschle, David Boren and Sam Nunn.

More than 300,000 copies of the abridged version of *Patient Power* were published and distributed. Many people regard the book as the driving force that derailed Hillary Clinton's plan to reform the U.S. health care system. Though unmentioned in the book, her plan was sidetracked when about 40 Republican senators signed on to a rival reform plan whose central focus was *Patient Power's* MSA concept.

Trial and Error. The idea of MSAs began to catch on in the private sector

as well:

- After NCPA Board member Pat Rooney tried the idea with his employees at Golden Rule Insurance, the company began selling MSA plans in the marketplace.
- *Forbes* magazine publisher Steve Forbes created a variant of the idea for his employees.
- Quaker Oats and Dominion Resources implemented their own versions.
- The United Mine Workers tried yet another twist: The union agreed to a $1,000 annual deductible as an alternative to first-dollar coverage in return for a $1,000 annual check from management for each employee.

Pilot Project for MSAs. These early attempts to implement MSA plans were at a disadvantage under the tax law. Unlike employer-paid premiums, MSA deposits were subject to income and payroll taxes, and unspent funds could not be rolled over to accumulate and earn tax-free interest. In 1996, however, Congress created a pilot project allowing tax-free MSAs for the self-employed and small businesses. The program mandated a cap of 750,000 policies, but numerous restrictions resulted in only a tenth that number being purchased. One of those restrictions was the design of MSA plans.

In the early 1990s, Goodman drew a diagram of a possible MSA plan for Ways and Means Chairman Bill Archer. [See the figure.] Subsequently, this design was codified — both in the pilot program and current HSA law. By contrast, the South African government took a similar approach, but allowed the market to innovate and experiment.

MSAs in South Africa. In 1993, Goodman helped Discovery Health launch an MSA plan in South Africa. The plan was very successful and rival insurers quickly copied it. Within a decade, MSA plans captured about two-thirds of the private insurance market.

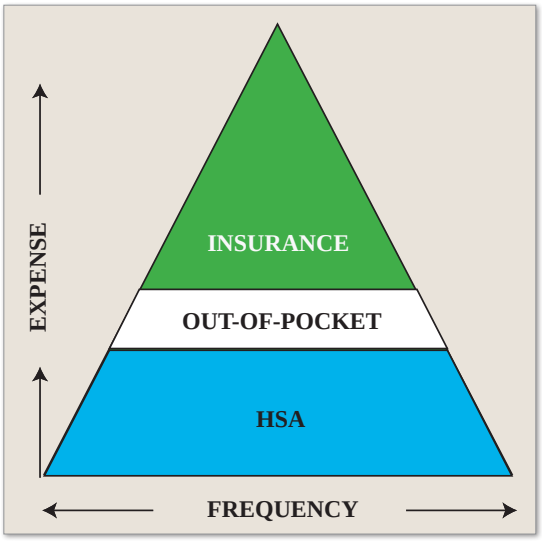
In a typical South African plan, there was no deductible for hospital care, on the theory that patients typically exercise very little discretion in a hospital setting. By contrast, there was a high deductible for out-patient care on the theory that patients exercise more discretion when choosing those services. However, the most popular South Africa plans would not be allowed under the rigid parameters that govern the U.S. market.

In 2014, in the United States, the health insurance policy that accompanies an HSA must have an across-the-board deductible of at least $1,250 for an individual or $2,500 for a family, with exceptions for preventive care.

Health Reimbursement Arrangements. In June 2002, encouraged by the NCPA and the Wye Group on Health, the U.S. Treasury Department issued a Revenue Ruling clarifying that unused funds in Health Reimbursement Arrangements (HRAs) — employer-funded accounts similar to HSAs — could be rolled over from year to year tax free. HRAs are very flexible. Employers, for example, can alter copayments and deductibles to encourage employees to buy medications for chronic conditions or to encourage preventive care.

There are some limitations: HRAs can never be cashed out and taken as compensation by the employee, and they are generally not portable. Thus, HRAs are essentially expense accounts with use-it-or-lose-it incentives. Nonetheless, they have been very important politically in building large employer support for consumer directed health care.

Health Savings Accounts. In contrast to HRAs, HSAs create an actual savings account that belongs to the worker, can travel from job to job, and be passed on to heirs. To a large extent, they allow people to choose between health care and other uses of money. Funds can be withdrawn and spent for nonhealth purposes after age 65, after paying normal income taxes.



Prior to age 65, a 20 percent penalty applies.

The Role of the NCPA. The National Center for Policy Analysis provided the intellectual justification and rationale for individual self-insurance. Between the time the NCPA task force was formed in 1990 and Health Savings Accounts became a reality in 2004, NCPA scholars made more than 250 presentations — speeches, briefings, testimonies, etc. — in virtually every state.

The NCPA produced numerous studies, backgrounders, brief analyses, articles and other publications in addition to scores of newspaper editorials in such places as the *Wall Street Journal, Washington Times and Investor's Business Daily.* The NCPA also sponsored nationally televised presentations including debates on Bill Buckley's *Firing Line* and the PBS program *Debates Debates.*

Conclusion. Health Savings Accounts is truly an idea whose time has come. More than 30 million people now control some of their own health care dollars through an HSA or HRA. HSAs promise to revolutionize the American medical marketplace. However, Congress should allow insurance companies and employers more flexibility to experiment and innovate, so that the market can discover what works best.

Devon Herrick is a senior fellow at the National Center for Policy Analysis.