

BRIEF ANALYSIS

No. 115

*For immediate release:
Thursday, July 14, 1994*

Medical Savings Accounts: The Momentum Builds

Medical Savings Accounts, also called Medical IRAs and Medisave Accounts, have more support in Congress than any other proposal to control health care costs.

Bipartisan Support. Just before the July 4th recess the House Ways and Means Committee approved Medical Savings Accounts (MSAs) by acclamation, and Senator Kennedy's Labor Committee endorsed MSAs in principle. House Republicans have backed MSAs for more than two years. Forty of 44 Senate Republicans are cosponsoring Minority Leader Bob Dole's bill, which features MSAs and additional reforms.

Grass Roots Support. MSAs also are popular with state legislators. For example, Arizona, Colorado, Idaho, Mississippi and Missouri have created Medical Savings Accounts under their state income tax laws, and Michigan and Illinois are preparing to adopt similar legislation. Three states have passed resolutions calling on Congress to allow MSAs, and legislation is pending in 13 others.

How Medical Savings Accounts Work. Under most proposals, individuals and their employers could make regular, tax-free deposits to MSAs, which would be the property of the individuals. They could withdraw money without penalty only to pay medical expenses or health insurance premiums. Money they did not spend would grow with interest, and they could use it for medical expenses after retirement, roll it over into an IRA or pension plan or leave it as part of their estate.

Medical Savings Accounts would give individuals a new way to pay for health care. Under traditional health insurance, people make monthly premium payments to an insurer such as Blue Cross, and the insurer pays medical bills as they are incurred. Under the new system, people could confine health insurance to catastrophic coverage (say, expenses above \$3,000), reduce their

monthly insurance premium payments and make deposits to a Medical Savings Account instead. Insurance would pay for expensive treatments that occur infrequently, while individuals would use their MSA funds to pay small bills covering routine services.

Employer Experiences With MSAs. Even without a tax break, a number of employers have adopted the MSA philosophy. For example, this year the United Mine Workers accepted a plan with a \$1,000 deductible. In return, each employee receives a \$1,000 bonus at the beginning of the year and employees get to keep whatever they don't spend. If UMW employees are similar to other employees around the country, they will cut back on their health care spending. For example:

- Until the IRS forced a change in the plan, Quaker Oats had a high-deductible policy and paid \$300 annually into the personal health accounts of employees, who got to keep any unspent balance; the result: over the past decade the company's health care costs grew at an average of 6.3 percent per year, while premiums for the rest of the nation grew at double digit rates.
- *Forbes* magazine pays each employee \$2 for every \$1 of medical claims they do not incur up to a maximum of \$1,000; the result: *Forbes'* health costs fell 17 percent in 1992 and 12 percent in 1993.
- Dominion Resources, a utility holding company, deposits \$1,620 a year into a bank account for the 80 percent of employees who choose a \$3,000 deductible; the result: the company has experienced no premium increase since 1989, while other employers faced annual increases of 13 percent.
- Golden Rule Insurance Company deposits \$2,000 a year into a Medical Savings Account for each employee who chooses a \$3,000 family deductible; the result: in 1993, the first year of the plan, *health costs were 40 percent lower than they otherwise would have been.*

Advantages of MSAs: Lower Costs. Primarily because of perverse incentives created by federal tax law, most Americans are overinsured. People use health insurance to pay for nonrisky medical episodes, including diagnostic tests and routine checkups. They also use health insurance to pay small medical bills they could pay more economically from personal funds. As a consequence, patients and their physicians are often wasteful, and the administrative costs of the U.S. health care system are much too high. Health care costs could be reduced substantially if people used Medical Savings Accounts:

- According to a computer model constructed by Milliman & Robertson for the Council for Affordable Health Insurance, the U.S. health care system would save almost \$588 billion over five years.
- According to a study for the Cato Institute, MSAs would lower the nation's annual health care bill by \$300 billion and reduce administrative costs by \$33 billion.

Advantages of MSAs: Higher Quality. Even without health care reform, people are increasingly finding their choice of doctors restricted, and bureaucracies are interfering with doctor-patient relationships. MSAs would give power and money to patients; doctors would become their agents rather than agents of bureaucracies; and people could exercise choice in the medical marketplace.

Advantages of MSAs: More People Insured. Most proposals would allow people to use their tax-favored MSA funds to continue coverage with a previous employer or to purchase a new policy while they are between jobs.

Other Advantages. Medical Savings Accounts would also help solve other problems. By restoring the doctor-patient relationship, MSAs would allow patients to make the tough choices between health care and other uses of money. By assuring that people have a store of funds available, MSAs would make it easier for families to obtain preventive medical care. And by putting money into the hands of consumers, MSAs would be a powerful positive force for competition in the medical marketplace.

Medical Savings Accounts Proposals

	House Ways & Means ¹	Dole	House Republicans
Open to:			
Employees	Yes	Yes	Yes
Self Employed	No	Yes	Yes
Other Individuals	No	Yes	Yes
Catastrophic Ins. Deductible:			
Individual	\$2,500	NS ²	\$1,800
Family	\$3,750	NS ²	\$3,600
Max. MSA Deposit:			
Individual	PS ³	\$2,000	\$2,500
Family	PS ³	\$4,000	\$5,000
Tax-Free Contribution	Yes	Yes	Yes
Tax-Free Interest	No	No	Yes
Catastrophic Ins. Required	Yes	Yes	Yes
Use of MSA Funds:			
Any Medical Expense	Yes	Yes	Yes
Catastrophic Ins. Premiums	No	No	Yes
Long-term Care	?	Yes	Yes
Long-term Care Premiums	?	Yes	Yes
Non-medical withdrawals	Not allowed before age 65	Taxes plus 10% penalty	Taxes plus 20% penalty

¹ Not permitted for employers who self-insure

² Not specified

³ Premium Savings. Employers and their employees are required to purchase a mandated package of benefits. If employees select the high-deductible plan, the premium savings must be deposited in a Medical Savings Account.

To order NCPA Policy Backgrounder No. 128, "Medical Savings Accounts: An Idea Whose Time Has Come," send \$5 to the National Center for Policy Analysis, 12655 N. Central Expy., Suite 720, Dallas, TX 75243.