

BRIEF ANALYSIS

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Medical Savings Accounts and the States: Growth From the Grassroots

While health care reform apparently has been assigned a low priority on the congressional agenda this year, the states have been aggressively and successfully moving toward free-market reform. Legislation allowing Medical Savings Accounts (MSAs) has been introduced or enacted in a majority of the states. Meanwhile, Washington and Minnesota have repealed the government-run health care reforms they had previously enacted. These developments are an epilogue to the 1993-94 health care debate, which centered around President Clinton's attempt to overhaul the nation's health care system.

How MSAs work.

Under most MSA proposals, individuals and their employers have the option of making tax-free deposits to the MSAs, which are the property of the individuals. Usually, MSA funds can be used to pay medical expenses or health insurance premiums. Money not spent grows with interest and can be used for medical expenses after retirement, rolled over into an IRA or pension plan or left as part of the person's estate.

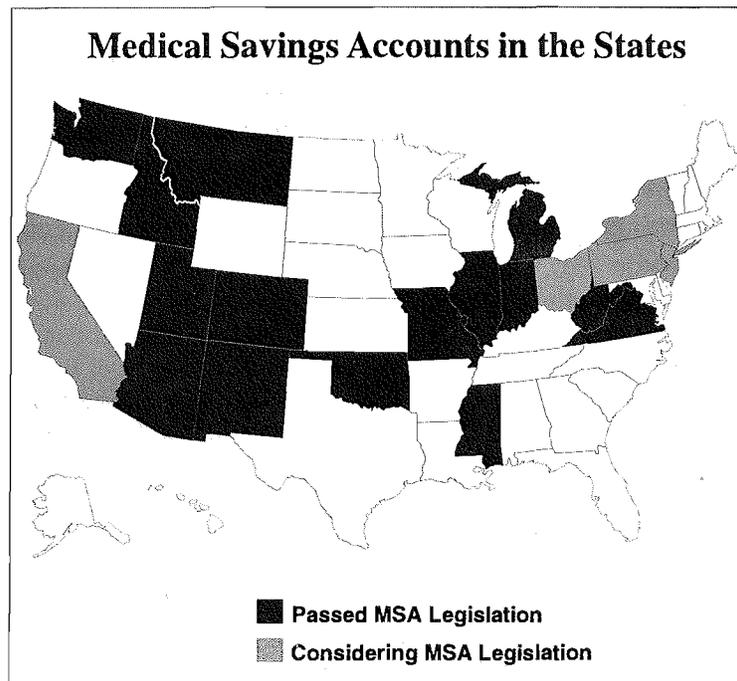
Medical Savings Accounts create a new way to pay for health care. Under traditional health insurance, individuals and their employers pay monthly premiums to an insurer such as Blue Cross, and the insurer pays

their medical bills. Under the new system, people can choose catastrophic health insurance coverage (for expenses above, say, \$3,000), reduce their monthly premiums and make tax-free deposits to a Medical Savings Account. Insurance then pays for infrequent but expensive treatments, and individuals pay small bills from their MSAs.

The state-level success of MSAs. Overall, MSA legislation has been the single most popular state health care initiative in 1995.

So far this year, 29 states have introduced MSA bills, and eight of those states have enacted them. Seven other states already had adopted MSA legislation, bringing the total to 15. Five additional states are actively considering MSA laws.

Moreover, at a time of considerable partisan bickering, MSA legislation in the states has garnered surprising bipartisan support.



- In three states, MSA legislation passed at least one of the legislative chambers unanimously.
- In five states, MSA legislation passed both chambers unanimously.
- In the remaining states, the legislation passed by an overwhelming majority.

The state-level structure of MSA legislation. Legislation at the state level exempts MSA deposits from state income taxes. While the maximum annual MSA deposit varies by state, the permissible deposit generally is higher than the maximum Congress is considering.

One of the most important features of state-level MSA legislation is that, in all but four of the states, it provides the tax break for everyone who purchases health insurance individually. This includes the self-employed and employees who do not receive health insurance from their employers. Under current federal law, the self-employed get only a 30 percent deduction, and other individuals receive no tax deduction. The new state laws enhance tax fairness and help individuals by removing the tax bias that favors employer-based health care, although the federal tax bias continues to exist.

Moreover, the majority of the states, modeling their legislation after that proposed by the American Legislative Exchange Council (ALEC), do not penalize non-medical withdrawals at the end of the year. Of the four states that do impose penalties, three have a 10 percent penalty for withdrawals made any time before the age of 59 1/2 and one enacted a penalty for withdrawals that reduce the account below \$4,000.

MSAs for Medicaid recipients and state employees. Medicaid, a federal-state program begun in 1965, enrolls 34 million Americans and costs taxpayers almost \$138 billion a year. Medicaid spending is exploding — it grew 21.8 percent annually between 1988 and 1992 — and is the fastest-growing component in most state budgets. As a result, the states have been looking for new and innovative ways to reduce Medicaid costs, including the use of MSAs.

Five states (Indiana, Louisiana, Ohio, Oregon and West Virginia), working from an ALEC-proposed model, introduced legislation that would have provided vouchers with an MSA option for Medicaid recipients. In addition, Texas enacted a pilot project to use MSAs for a limited number of Medicaid recipients. Other states such as Ohio and Washington are considering MSAs for state employees.

The benefits of MSAs at the state level. The enactment of MSAs at the state level is producing a number of benefits.

(1) *Passage at the state level is encouraging companies to provide an MSA option.* Approximately 1,000 employers now offer some form of Medical Savings Accounts to their employees. This trend has been driven by the actual savings in health care spending the employ-

ers and employees have realized using MSAs. For example, Golden Rule Insurance Company of Indianapolis has been offering Medical Savings Accounts to its employees since 1993. This year Indiana enacted MSA legislation that will allow the employees of Golden Rule to avoid paying state taxes on their MSA deposits. This tax break will result in an additional \$53,000 going into their MSAs to be used for health care.

(2) *Debate over MSA legislation has educated Americans about the MSA option.* Only a few years ago, very little was known about MSAs. Today, citizen groups are forming for the sole purpose of supporting MSAs at the state level. In addition, many more employers now understand the concept and are considering ways to offer this option to their employees. State action also has encouraged insurance companies, banks and entrepreneurs to begin looking at the idea of marketing and selling catastrophic insurance with MSA plans.

(3) *The state-level popularity of MSAs has led Congress to consider legislation at the federal level.* In the past, many Congressmen expressed skepticism about MSAs, but state-level support has helped change many opinions. For example, Senator Paul Simon (D-IL) reexamined the MSA issue after his state enacted MSAs last year, and he now supports federal legislation.

MSAs at the national level. In order to give MSA depositors the same tax break the purchasers of third-party insurance and members of health maintenance organizations (HMOs) enjoy, Congress must change the federal tax code. On June 13, 1995, House Ways and Means Committee Chairman Bill Archer (R-TX) introduced legislation that provides for Medical Savings Accounts. The bill already has more than 80 cosponsors, and might attract others if the 10 percent penalty for nonhealth care-related withdrawals were removed.

Congress should take note of the overwhelming success of MSAs at the state level. Their success demonstrates that the American people want Medical Savings Accounts and that the private sector is ready to provide them.

This Brief Analysis was prepared by Molly Hering Bordonaro, Senior Legislative Director of the American Legislative Exchange Council, a bipartisan association of state legislators and businesses.