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Are Medical Savings Accounts Good for the Sick?

Congress is on the verge of passing Medical Savings Account (MSA) legislation that would (1) allow employers to make tax-free deposits to MSAs for their employees, (2) permit people who purchase their own health insurance to make tax-deductible deposits to MSAs and (3) allow seniors covered by Medicare to choose an MSA plan as an option. Are these options a good idea?

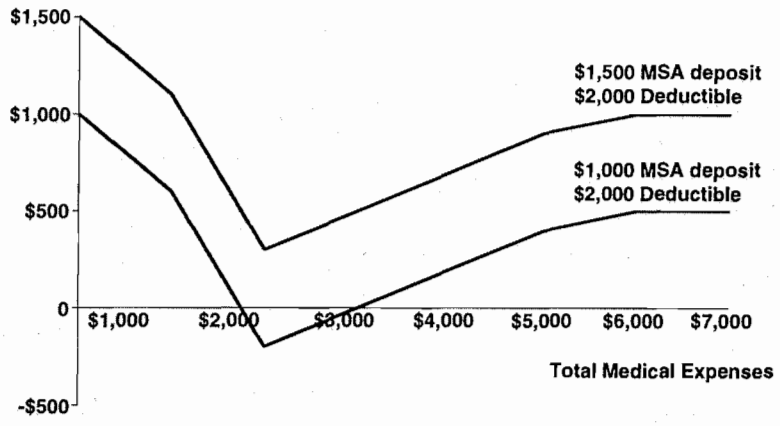
Critics assert that Medical Savings Accounts are good for the healthy and bad for the sick. Given a choice, they say, only the healthy would choose MSAs, and that would drain from the general insurance pool funds needed to pay the medical bills of others.

This viewpoint may be found almost every week on the editorial pages of the *New York Times*. It is expressed almost daily by congressional Democrats who oppose health care reform. And this thinking underlies the recent negative assessment of MSAs for Medicare by the Congressional Budget Office (CBO).

The facts tell a different story. People with high medical expenses are almost always better off if they can switch to a Medical Savings Account plan. If any are worse off as a result of the switch, they lose very little. For example, an MSA plan would be a bonanza for high-cost Medicare patients, who would gain a lot more than healthy seniors from such a plan.

The people who gain the least by switching to an MSA plan are not the very sick, but chronic patients with moderately expensive-to-treat conditions — people who generate medical bills in the range of $2,000 to $5,000 per year. But even this group would likely find MSAs attractive. Let's see why.

Net Gain/Loss From Switching to a Medical Savings Account Plan[1]



[1] Assumes a switch from a conventional health plan with a $500 deductible and a 20 percent copayment up to a maximum out-of-pocket limit of $1,500. The net gain is the difference between the MSA end-of-year refund (or out-of-pocket expenses under the MSA plan) and out-of-pocket expenses under conventional insurance.

The Design of MSA Plans. The idea behind Medical Savings Accounts is that people should be able to select high-deductible rather than low-deductible insurance and have the premium savings put into an account they can use to pay small medical bills. As many as 1,000 employers are now offering MSA plans to their employees. These plans differ from traditional insurance in three important ways.

First, instead of making out-of-pocket expenses (to reach a deductible) the first tier of a health plan, MSA plans give the insured access to cash up front. Thus a single mother living from paycheck to paycheck will not neglect to take her child to a doctor because she can't pay the fee. Yet she has an incentive to spend her MSA funds wisely because at year-end she gets to withdraw for any use any money remaining in the account.

Second, rather than have a copayment that applies to small as well as large bills, MSA plans concentrate out-of-pocket spending in a single corridor — the gap between the MSA deposit and a catastrophic deductible. For example, with a $1,500 MSA deposit and a $2,000 deductible, patients spend the first $1,500 from the MSA and the next $500 out of pocket, then rely on catastrophic insurance to pay all expenses above $2,000. Many MSA plans rely on managed care, or at least a (preferred provider) network of physicians, to control costs above the deductible.

Third, because MSA plans create more efficient (and more appropriate) incentives for patients, they are almost always able to offer their enrollees lower total out-of-pocket exposure than can traditional plans purchased

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with the same premium dollars. While the latter leave people exposed for several thousand dollars of medical bills, MSA plans usually limit this exposure to $1,000 or less. In the above example, total out-of-pocket exposure is only $500.

Winners and Losers. Would *you* be better off or worse off with an MSA plan? To answer that question, you must consider all possible contingencies — including the possibility that you will have small bills as well as large ones.

As the figure shows, healthy people clearly are better off with MSAs. Continuing with the above example, a person with no medical expenses would be able to withdraw the annual $1,500 MSA deposit at year-end and spend the money on nonmedical goods and services. But sick people also do well under such a plan. Someone with $10,000 in medical expenses would pay only $500 out of pocket. Under a conventional insurance plan that person would have paid $1,500, of which $500 would be the deductible and $1,000 would be a 20 percent copayment on the next $5,000 of expenses.

The person who does least well is someone with moderate expenses. This is because in the corridor between the MSA deposit and the catastrophic deductible, the patient is paying an out-of-pocket dollar for a dollar of medical care. By contrast, a person with conventional insurance would be paying out of pocket only 20 cents on the dollar for medical expenses in this range.

The Chronically Ill. In general, someone with $2,000 to $5,000 of medical expenses is (1) experiencing a brief medical episode from which recovery will be relatively quick, (2) on the way toward a serious illness with large future medical bills or (3) suffering from a chronic condition that lingers from year to year (e.g., diabetes). For the reasons given above, people in the first two categories would be better off, over time, with Medical Savings Accounts. By contrast, the figure shows that people with moderately expensive-to-treat chronic conditions might experience little financial gain by choosing an MSA plan over traditional insurance. But they are likely to prefer MSA plans for two reasons.

First, there is often considerable variation in the cost of treating chronic conditions. Given proper incentives, patients and their doctors can lower the cost of care — thus leaving the patient with a greater end-of-year refund. Second, even under traditional insurance, the chronically ill are increasingly hassled by managed care bureaucrats who want to impose a cookbook approach on both patients and doctors. Many chronic patients believe that if they could manage their own health care dollars they would get not only better but also less expensive care.

Seniors on Medicare. What is true of the nonelderly population applies in spades to seniors, who can be bankrupted by medical bills even though they are covered by Medicare. Indeed, more than 400,000 seniors face out-of-pocket expenses in excess of $5,000 every year for Medicare-covered services.

In a study for the National Center for Policy Analysis, the actuarial firm Milliman & Robertson calculated that Medicare dollars could be used to create genuine catastrophic insurance above $3,000 and still deposit $2,100 in an MSA for all seniors who chose the plan. This means that *the most a senior would pay out of pocket would be $900.*

Currently, about 70 percent of the elderly purchase supplemental (medigap) insurance at a cost of about $1,200 a year. Under the MSA plan, such purchases would be unnecessary. They could put the money in the bank instead.

Conflicting Studies. The conclusions reached here are consistent with studies produced by the American Academy of Actuaries and the Urban Institute. They are inconsistent with a Lewin-VHI study, which concluded that MSA plans would appeal only to the healthy. *But the Lewin study ignored out-of-pocket expenses, having completely misunderstood what MSAs are designed to do.* It appears that the CBO made similar errors.

Conclusion. Progress in health care reform has been delayed until now because the "experts" most often consulted represented the traditional insurance or HMO mentalities. Neither group understood MSAs or had ever worked with a real MSA plan.

Public understanding of policy options is being elevated considerably as the opinions of health policy analysts who understand the patient power revolution are finally beginning to be heard.

This Brief Analysis was prepared by NCPA President John C. Goodman.