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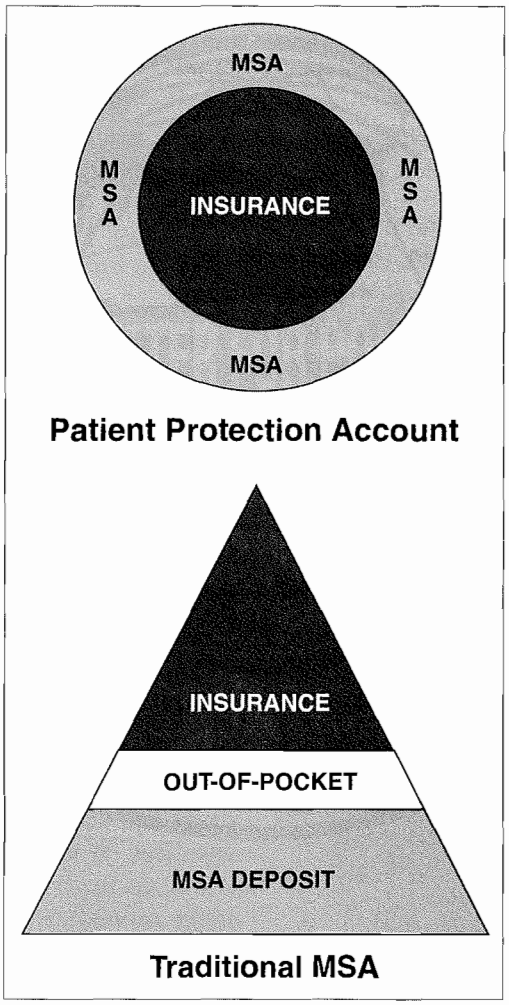
Patient Protection Accounts: Personal, Portable and Affordable

Although tax law generously subsidizes the employer payment of third-party health insurance premiums, it provides virtually no tax relief to those who pay medical bills directly. Thus the tax law encourages people to turn over all of their health care dollars to a third party. The results have not all been positive.

Managed care appears to have succeeded in reducing the growth of health care spending. But it also has interfered with the doctor-patient relationship, often making doctors feel they are agents for a managed care bureaucracy more than agents of their patients. Critics believe that managed care has lowered the overall quality of care. Anecdotal horror stories are numerous. Voters are complaining. Politicians are ready to act.

What should they do?

Protecting Patients Through Regulation and Bureaucracy. Many advocate keeping the current economic incentives in place, while piling restrictions on the managed care industry. For example, under some "patient's bill of rights" proposals, enrollees would be able to see nonnetwork doctors and health plans would be forced to pay those doctors the same fees they pay to doctors within their network. Another restriction would prohibit health plans from creating economic incentives for physicians to withhold care. These types of regulations would destroy the traditional HMO, and limit the ability of managed care organizations to hold down costs. As a result, they threaten to cause the reemergence of health care inflation.



Protecting Patients Through Patient Power. A different approach is to change fundamental incentives by giving patients more control. For example, if health insurance worked like casualty insurance, insurers would pay a fixed sum for a treatment, but patients would choose the provider. The patient would pay the extra costs, but the provider would see the patient rather than a third party as the customer. Another empowerment idea would make patients responsible for whole categories of care — say, all preventive and diagnostic services. These changes would require that patients control many of their own health care dollars, and they would require a change in the tax law.

Why Medical Savings Accounts Are Inadequate. In order to give people more control over their own health care dollars, Congress has authorized two Medical Savings Account (MSA) pilot programs — one for the elderly on Medicare and the other for small businesses and the self-employed. For the nonelderly, however, tax-advantaged MSAs must be combined with high-deductible health insurance and used to pay small expenses not covered by the plan. [See the diagram.] This makes MSAs inadequate to deal with the challenge of managed care for three reasons:

- Contributions to tax-free MSAs can be made only by people with qualified high-deductible plans, thus excluding enrollees in HMOs and many other managed care plans.
- The MSA deposit is mainly designed to pay deductible expenses and in most cases is exhausted at the point where third-party (often managed care) payment takes over.

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- Withdrawals from the MSA face taxes and penalties unless they are used to purchase medical care or health insurance, which forces the MSA to operate less like real self-insurance and more like prepayment for the consumption of medical care.

A Better Solution: Patient Protection Accounts. To make the tax law more neutral with respect to the use and withdrawal of health savings, we propose the creation of Patient Protection Accounts. With a PPA:

- Individuals could make aftertax deposits to the account, regardless of the type of health insurance they have.
- Employers could make PPA deposits on behalf of their employees.
- PPAs would be designed to wrap around any third-party insurance plan, including an HMO, Preferred Provider Organization (PPO), Point of Service (POS) plan or a traditional indemnity plan — providing funds with which to pay medical expenses not paid by the plan.
- Like the new Roth IRA, deposits to PPAs would be made with aftertax dollars, and after a 12-month insurance period withdrawals could be made for any reason without taxes or penalties.

Patient Protection Accounts would create a new option without taking away any current option.

Personal, Portable and Affordable. Patient Protection Accounts would solve a number of the problems people currently face in the health care system. PPAs would be:

Personal. Unlike employer-based health insurance, PPAs would belong to the individual, not the employer. Account balances would be part of a person's estate at death.

Portable. Since PPAs would belong to the individual, they would move with employees from job to job and could be used to pay health insurance premiums between jobs.

Affordable. Contributions to PPAs would be strictly voluntary, and they could easily be integrated with the employee's personal savings plans.

These proposals have several advantages:

- Enrollees in HMOs and other managed care plans would be able to make PPA deposits and use the funds to pay for doctors visits, diagnostic tests and other services not paid for by their health plan.
- Participants in Point of Service plans could use their PPA funds to pay the (often higher) fees charged by nonnetwork physicians.
- Employers and insurers would have much more flexibility in designing plans; for example, they could provide first-dollar coverage for some services (e.g., preventive tests) and high deductibles for others without jeopardizing the ability of the insured to have a PPA.
- A casualty insurance approach — one that pays fixed fees for treatments — would become more viable because if the fixed fee proved insufficient, people could use their PPA funds to pay the difference.
- Because PPA withdrawals would be tax-free, people could have their money back or continue to save it without penalties if they had no medical expenses.
- Because PPA withdrawals would be tax-free, people could make unbiased choices among medical care, other goods and services and personal savings.

Taking Full Advantage of Managed Care. Although PPAs may be thought of as an antidote to the problems of managed care, they may make traditional HMOs more attractive. Consider a staff model HMO that only pays for the services of doctors in its network and for drugs on its formulary and that rigorously scrutinizes requests for CAT scans and other expensive tests. Individuals could join such a plan and put the premium savings in a PPA from which to pay for doctors visits, drugs and tests if the plan refuses to authorize them. If enrollees do not have to go outside the plan, they can withdraw the funds at the end of the year or leave them in the account to grow tax free.

Conclusion. PPAs would change the way the health care marketplace responds to the perceived deterioration of health care quality that has emerged with the growth of managed care. They would give people more access to health care, more choice and better protection than most proposals for a patient's bill of rights.

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