National Center for Policy Analysis

BRIEF ANALYSIS
No. 356
For immediate release:
Thursday, April 19, 2001

MSAs for Everyone, Part III

By John C. Goodman

The idea behind Medical Savings Accounts (MSAs) is that individuals are able to own and control some of their own health care dollars. Instead of turning all the money over to an employer or insurance company, part of the funds are placed in an account from which patients pay directly for medical services. Further, individuals ultimately get to keep any MSA funds they do not spend.

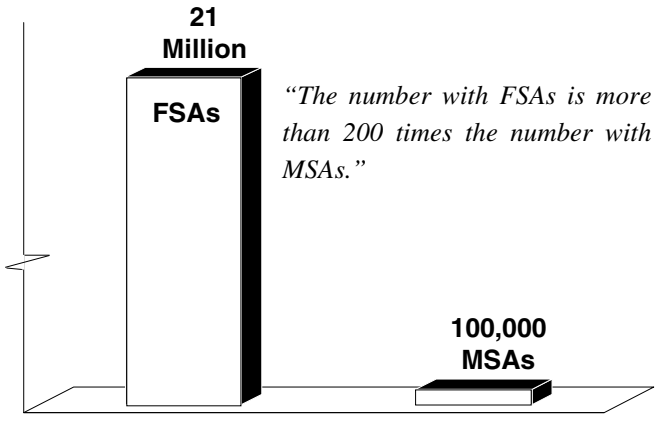
MSAs work well for those who have them. So well, in fact, that everyone should have one.

Advantages of MSAs. Medical Savings Account plans have proved remarkably popular among the small number of people who currently have one. Employers like them because they give employees incentives to control costs. Employees like them because they get to keep any funds they do not spend. And employees can make their own decisions about the trade-off between money and health care services, rather than have those decisions made by an impersonal bureaucracy.

Doctors like MSAs because they can practice medicine as agents of their patients rather than as agents of employers or insurance companies. When doctors are free to put the welfare of patients first, patients are likely to get better health care.

How the Tax Law Discourages MSAs. So why doesn't everyone have an MSA? The problem is the tax law. Employer premium payments are excluded from employees' taxable income — a tax subsidy that can be worth 50 cents on the dollar for many middle-income employees. On the other hand, since employer deposits to MSAs are taxed at the time the deposit is made, Uncle Sam takes as much as half the money the employer tries to deposit. In this way, the tax law then encourages a system under which we give all our health care dollars to a third-party payer.

Number of People Using Accounts



"The number with FSAs is more than 200 times the number with MSAs."

Source: Bureau of Labor Statistics, and U.S. Office of Personnel Management.

The MSA Pilot Program. An exception to the tax law is a federal pilot program passed in 1996. The program allows tax-free deposits to MSAs for the self-employed and employees of small business. But because of unfriendly rules and restrictions, only a fraction of people who are eligible have actually enrolled in an MSA plan.

One problem is that the law allows a maximum of only 750,000 MSA enrollees. This means that large insurers lack the incentive to market an MSA product the way they marketed Roth IRAs. Another problem is the severely restrictive rules governing deductibles. For example, the law requires families to have a $3,000 across-the-board (covering all services) deductible, regardless of how much is in the family's MSA. As a result of such restrictions, only about 100,000 households actually have a tax-free MSA today.

MSAs in South Africa. In contrast to the U.S. experience, MSAs are flourishing in South Africa. Beginning in the early 1990s and continuing throughout the Nelson Mandela regime, South Africa had a relatively free market for health insurance. HMOs, PPOs, MSA plans and virtually every other type of health plan available in the U.S. have been competing on a level playing field in South Africa for almost a decade. The result: MSA plans have captured more than half the market for private insurance.

Why have MSA products been so successful in South Africa, while languishing in the United States? The answer is that South African MSAs are the product of market forces, not government decree. For example, there *is* no law stipulating how high or how low the deductible has to be. In fact, in a typical plan there are different deductibles for different services.

Under one popular South African plan, patients face no deductible when they enter a hospital, on the theory that it is difficult for patients to exercise choice in that setting. However, for outpatient care (where patients exercise much more discretion), the deductible is set at about $1,200. The deductible drops back to zero for

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certain drugs, especially in cases where failure to take them could lead to more costly care later on.

A Near MSA: Flexible Spending Accounts. Millions of workers already have access to a tax-free account that has all of the flexibility of MSAs in South Africa. These are called Flexible Spending Accounts (FSAs). They work like this: at the beginning of the year, employees agree to monthly, pretax payroll deductions that are deposited into their FSA. During the year, employees can use their accounts to pay for medical services not covered by their health insurance plan. FSA accounts allow direct purchase of medical care and receive the same breaks under the tax law as employer payments of health insurance premiums. Further, the number of people using FSAs is more than 200 times the number with a conventional MSA.

The problem is that FSA accounts are governed by a use-it-or-lose-it rule. Any money left in the account at year-end is forfeited. So instead of encouraging people to spend prudently, end-of-year FSA balances encourage people to search for ways to spend money — on more expensive eyeglasses, more diagnostic tests or other services the IRS considers "health care."

Turning Flexible Spending Accounts Into Flexible MSAs. What is needed is a small change in the current law that would turn FSAs into MSAs:

- Employees could make pretax deposits to the account regardless of the type of health insurance they have, just as they can under current law.
- Employers could make FSA deposits on behalf of their employees, as they can under current law.
- Unlike the current use-it-or-lose-it restriction, unused FSA balances would roll over tax free.
- Beyond a 12-month insurance period, FSA account owners could move their deposits to an account managed by any qualified institution.
- Funds could be subsequently withdrawn for nonmedical purposes, provided income taxes are paid.

These FSA accounts would create a new option without taking away any current option. Some may be concerned that employees would use their FSAs as a way to augment their tax-deferred saving. Such an outcome is not bad, but it could be prevented: Simply limit the annual IRA contribution plus FSA rollover to the maximum allowable IRA deposit (currently $2,000 per person).

Personal, Portable and Affordable. The new FSA accounts would solve a number of the problems people currently face in the health care system. These accounts would be:

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

Portable. Since the new FSAs 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 FSAs would be strictly voluntary, and they could easily be integrated with the employee's personal savings plans.

Other Advantages. This proposal has several additional advantages:

- Enrollees in HMOs and other managed care plans would be able to make FSA deposits and use the funds to pay for doctor visits, diagnostic tests and other services not paid for by their health plan.
- Participants in Point of Service plans could use their FSA funds to pay the (often higher) fees charged by nonnetwork physicians.
- Employer and insurers would have much more flexibility in designing plans; for example, they could provide first-dollar coverage for such services as preventive tests and high deductibles for other services without jeopardizing the ability of the insured to have an FSA.
- 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 FSA funds to pay the difference.

Conclusion. Using FSAs as MSAs would change the way the health care market 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.

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