National Center for Policy Analysis

BRIEF ANALYSIS
No. 105
For immediate release:
Wednesday, April 20, 1994

Medical Savings Accounts

The Private Sector Already Has Them

All across the country, private employers are discovering a new way of controlling health care costs. It works so well that at some companies health care costs are actually going down. The secret: giving employees incentives.

Take the United Mine Workers, for example. Last year they had a health plan with first-dollar coverage for most medical services. This year they 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. As a result, the mine workers still have first-dollar coverage, but now, the first $1,000 they spend will be their own money rather than their employers' money.

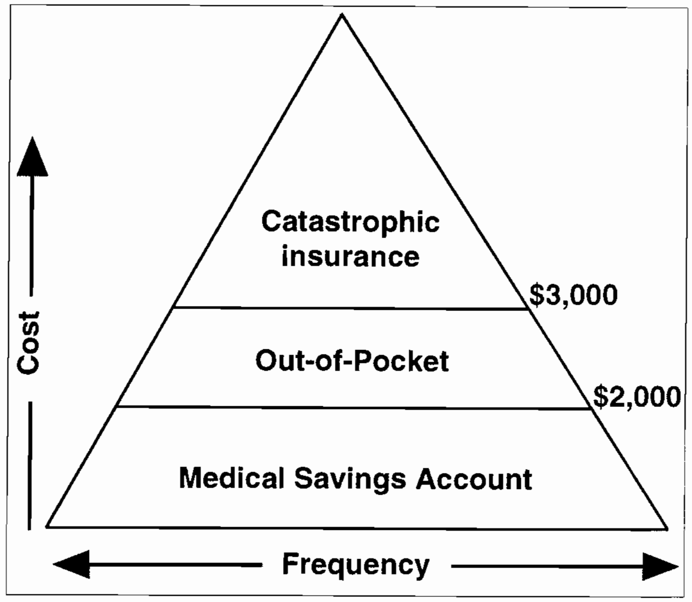
If the mine workers are like other employees, they and their families will respond to the new incentives by finding numerous ways to cut out waste and reduce their health care spending.

Saving Money by Empowering Employees. Most health economists agree that the primary reason why health care costs are rising is that the money we are spending in the medical marketplace is usually someone else's.

More than a decade ago, the Rand Corporation discovered that when people are spending their own money on health care they spend 30 percent less with no adverse effects on their health. Some employers are putting this principle to work:

- Since 1982, Quaker Oats has had a high-deductible policy and paid an annual $300 into the personal health accounts of employees, who get to keep any unspent balance; the result: over the past decade the company's health care costs have been growing an average of 6.3 percent per year while premiums for the rest of the nation have grown 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 rather than a lower 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 (MSA) for employees who choose a $3,000 family deductible [see the figure]; the result: in 1993, the first year of the plan, *health costs were 40 percent lower than they otherwise would have been.*

Why Employees Like Medical Savings Accounts. These plans are popular with employees because: (1) they can save money in an amount directly related to their own efforts; (2) they are not deterred from seeking medical care by the traditional out-of-pocket deductibles; (3) they can usually use their medical savings to buy

Dallas Headquarters: 12655 N. Central Expy., Suite 720 • Dallas, TX 75243-1739 • 214-386-6272 • Fax: 214-386-0924
Washington Office: 727 15th St. N.W., 5th Floor • Washington, DC 20005 • 202-628-6671 • Fax 202-628-6474
For more information: Jeanette Nordstrom 214/386-6272

services not covered by the employer's plan; and (4) they are usually not restricted to certain doctors as they would be under managed care plans.

Take Golden Rule's experience, for example. As the table shows, employees can choose a traditional policy with a $500 deductible and a 20 percent copayment up to a maximum of $1,000. If they choose a high deductible, however, Golden Rule deposits $1,000 (individual) or $2,000 (family) into their medical savings account in 12 equal installments.

Last year, 80 percent chose the medical savings account option, and in 1994 the number is up to 90 percent. It's not hard to understand why. At year-end 1993, employees withdrew the surplus remaining in their MSAs — an average of $602 per employee. These funds were a direct reward for being a prudent shopper in the medical marketplace.

Options For Golden Rule Employees

	INDIVIDUAL		FAMILY	
	Conventional Policy	Medical Savings Account Policy	Conventional Policy[1]	Medical Savings Account Policy
Maximum deductible	$500	$2,000	$500	$3,000
Maximum copayment	$1,000[2]	- 0 -	$1,000[2]	- 0 -
MSA deposit	- 0 -	$1,000	- 0 -	$2,000
Total out-of-pocket exposure	$1,500	$1,000	$1,500	$1,000

[1] The figures in this column are per family member up to a maximum of three people.

[2] 20 percent of the first $5,000 of expenses above the deductible.

Why Employers Like Medical Savings Accounts. When employees save money for themselves, they save for their employers as well. For example, at Golden Rule last year, medical costs above the catastrophic limits were about 60 percent of what had been projected.

What About Preventive Medical Care? Some critics claim that MSAs will encourage people to avoid preventive care. Yet experience shows the reverse is true.

With MSAs, people get preventive care that they might have otherwise postponed.

MSAs make money available immediately when the medical need for it exists. This allows people to make purchases they might not make if they had a traditional deductible requiring an immediate out-of-pocket payment. A survey of Golden Rule employees who opted for MSAs found that *one out of every five used their MSA for a medical service they would not have purchased under the traditional insurance plan.*

What About Adverse Selection? MSAs benefit the sick as well as the healthy. For example, those Golden Rule employees who are certain to have more than $3,000 of expenses are better off choosing MSAs. That's because their overall out-of-pocket costs will be lower. Moreover, Golden Rule allows employees to borrow against future MSA deposits in cases of catastrophic illness that occur early in the year.

What About Taxes? Under current law, unspent medical savings account balances are taxable, but health insurance premiums paid by an employer are not. Thus the tax law subsidizes third-party insurance and penalizes individual self-insurance. In this way, the tax law subsidizes the problem and penalizes the solution. Wise tax policy would give just as much encouragement to self-insurance through medical savings accounts as it gives to third party insurance.

Recommended Reading: John Merline, "Employees as Health Reformers," *Investor's Business Daily*, March 18, 1994; and Rachel Wildavsky, "Here's Health-Care Reform That Works," *Reader's Digest*, October 1993.

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