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WHAT'S IN A NAME? HOUSE BILL WOULD CHANGE NAME BUT NOT THE SUBSTANCE OF A PROPOSED EXPANSION OF MEDICAL SAVINGS ACCOUNTS

House to Consider MSA Expansion that Could Drive Up Insurance Costs, Increase the Number of Uninsured, and Provide Tax Shelters to Healthy, Affluent Individuals

By Edwin Park and Iris J. Lav

Executive Summary

On June 26, the House passed H.R. 2596 — proposed tax legislation that includes provisions to establish "Health Savings Accounts." The bill was then merged into the House-passed Medicare prescription drug bill before the drug bill was sent to conference with the Senate. Despite the slightly different name, these new Health Savings Accounts are virtually identical to Medical Savings Accounts (MSAs), and the provisions the House will consider are essentially identical to the proposal to greatly expand MSAs included in the Administration's fiscal year 2004 budget. (At a cost of $173.6 billion over 10 years, H.R. 2596 also includes provisions to establish "Health Savings Security Accounts" and expand Flexible Spending Accounts; those provisions are examined in a companion analysis.[1])

Few would propose a tax cut targeted toward healthy, affluent people that increases health insurance premiums for those who are sick. That is the probable consequence, however, of the Health Savings Accounts proposal coming to the House floor.

As noted, this proposal mirrors an Administration proposal to expand Medical Savings Accounts.[2] Established under a national demonstration project scheduled to expire at the end of 2003, MSAs are tax-advantaged personal savings accounts that are maintained in conjunction with high-deductible health insurance policies. Funds in MSAs may be used to help pay for health care expenditures that the high-deductible polices do not cover. These funds also may be retained unused in the MSA accounts and placed in investment vehicles such as stocks and bonds, with the investment earnings accumulating tax-free in the accounts. Eventually, the funds

[1] See Edwin Park, Joel Friedman and Andrew Lee, *Health Savings Security Accounts: A Costly Tax Cut that Could Weaken Employer-Based Health Insurance*, Center on Budget and Policy Priorities, Revised July 8, 2003.

[2] U.S. Department of Treasury, *General Explanations of the Administration's Fiscal Year 2004 Revenue Proposals*, February 3, 2003.

in these accounts may be withdrawn not only for medical purposes but also for *non*-medical purposes such as retirement. As a result, MSAs can be used as a tax shelter.[3]

MSA use currently is limited. MSAs may be set up by self-employed individuals and people employed at small businesses. Small firms may offer MSAs and high-deductible plans and make tax-advantaged deposits into their employees' MSA accounts, or individuals employed at such firms may establish MSAs themselves and make their own deposits into them. Deposits into MSAs by individuals are tax deductible.

The House bill (and the Administration's budget) would greatly expand MSAs. Proponents of large-scale expansion argue that it would increase health insurance coverage and thereby reduce the ranks of the uninsured. But most health analysts disagree. Leading analysts and research institutions have concluded that the effect is likely to be the reverse.

In particular, an array of analyses by respected research institutions has found that widespread use of MSAs could adversely affect the employer-based health insurance market by causing the cost of traditional, low-deductible insurance coverage that provides comprehensive benefits to spiral. As a result, significant numbers of employers might no longer be able to afford to offer traditional plans. The loss of such plans would place in jeopardy large numbers of older and sicker employees, who particularly need such coverage.

The national MSA demonstration project has produced no evidence to dispel the disturbing findings that emerge from this body of research. Despite these strong warnings, the House bill and the Administration's budget would repeal most current protections and limitations related to MSAs, to make MSAs more lucrative as tax shelters for affluent, healthy individuals — and hence more attractive to such individuals — and to allow unlimited expansion of MSAs across the country. These MSA expansions have long been pushed by insurance companies that sell MSA policies and conservative policy institutions. The MSA proposals would cost the Treasury $5.7 billion over ten years, according to the Joint Committee on Taxation.

The research on MSAs suggests that strong caution should be exercised with respect to these proposals. The risks that the proposals present stem from the following factors.

1. **Widespread use of MSAs could jeopardize coverage for substantial numbers of Americans in traditional health insurance by causing premiums for traditional insurance to rise markedly; research by the RAND Corporation, the Urban Institute, and the American Academy of Actuaries has found that premiums for traditional insurance could *more than double* if MSA use becomes widespread.**

    - MSA plans operate in conjunction with high-deductible insurance policies. Participants can use funds they or their employers have deposited in their Medical Saving Accounts to cover part of the out-of-pocket medical costs that the participants incur as a result of the high-deductible policies.

[3] A penalty applies to the withdrawal of funds from MSAs for non-medical purposes but there is no penalty for withdrawal for retirement. MSA accounts can serve as a tax shelter even in many cases in which a penalty would apply.

- People who incur substantial medical costs generally do not fare well under such arrangements. To obtain health care services that normally would be covered under traditional comprehensive insurance, these people must spend much more of their own money. If they do not have significant income or assets, they may not be able to afford these costs and may be forced to forgo needed health care treatments.

- By contrast, people who are quite healthy can find such arrangements attractive; if they use little health care, they can accumulate funds in their MSAs on a tax-advantaged basis, since earnings accumulate tax free in the accounts. In addition, as noted above, any funds that individuals deposit in their MSAs are tax deductible. Healthy people who are affluent can find this particularly advantageous, since they are better able to afford to make large deposits into MSAs and since the tax benefits that MSAs provide are worth the most to people in the higher tax brackets.

- These features of MSAs make them especially prone to what economists and health analysts call "adverse selection," under which healthier people abandon one type of health insurance for another. When this occurs, the people who remain in the traditional type of insurance constitute a group that is less healthy — and hence more expensive, on average, to insure. If MSAs are opened up for widespread use, then young, healthy people who anticipate facing few health care costs in the year ahead may choose to participate in them in substantial numbers. But older and sicker people who judge they are likely to incur significant health care costs would tend *not* to participate; they would be better off remaining in traditional health insurance, which typically has much lower deductible amounts, includes relatively low co-payments, and provides a comprehensive set of benefits.

- If MSA use become widespread and substantial numbers of healthier people choose MSAs and high-deductible policies while less healthy people do not, the pool of people who remain in traditional comprehensive health insurance will be sicker, on average, and more expensive to insure than it is today. As a result, premiums charged for comprehensive insurance policies will have to increase, perhaps by very large amounts.

2. **Despite these risks, the House bill and the Administration's proposal are designed to lead to substantially expanded MSA use, through elimination of all limits on the use of MSAs and changes in MSA rules that would make MSAs more lucrative as tax shelters**.

    - The House bill and the Administration proposal would make MSAs available to any individual who wishes to participate. This is a sharp departure from current practice, under which only workers who are in small businesses or are self-employed can use a MSA and no more than 750,000 MSA policies may be written nationwide. Under the legislation, any individual could use an MSA, and any employer — rather than just small firms — could offer them.

- This would open up MSAs on a broad basis to affluent, healthy individuals, for whom they could be quite valuable as tax shelters. MSAs bear strong similarities to tax-deductible Individual Retirement Accounts in that the deposits an individual makes into these accounts are tax-deductible and the earnings that accumulate in the accounts are tax-free. The funds in the account are never taxed as long as they remain in the account or are withdrawn for medical purposes. (The funds are subject to taxation if withdrawn for non-medical purposes, just as funds in tax-deductible IRAs are subject to taxation when withdrawn.)

- But MSAs differ from IRAs in one key respect — *there are no income limits on MSAs that prevent wealthy people from making tax-deductible contributions to them* and using them as a way for accumulating tax-free earnings on investments. This is of particular significance because the higher an individual's tax bracket, the greater the tax benefit an MSA provides.

- By opening MSAs up for widespread use, the legislation thus would enable high-income individuals to circumvent the IRA income limits by using MSAs for the same purpose — as tax shelters to accrue substantial assets over time on a tax-advantaged basis. It should be noted that at retirement, funds can be withdrawn from MSAs penalty-free for *non*-medical purposes.

- In addition, the legislation would enlarge the value of MSAs as tax shelters by increasing the amount that can be deposited in an MSA each year on a tax-deductible basis.

- If MSAs become universally available and the amount of money that can be sheltered from taxation though MSAs is increased, the tax advantages of MSAs to healthy higher-income taxpayers are likely to be marketed widely by banks and investment houses — much as IRAs are advertised — leading to further growth in MSA use.

The likely result of the legislation would be substantially increased MSA use. That, in turn, would likely drive up premiums in the traditional health insurance market.

3. Another reason that MSA use is likely to become more widespread under the legislation is that the legislation would be likely to lead a substantial number of employers to substitute MSAs and high-deductible insurance policies for traditional comprehensive employer-based insurance.

- Faced with rising health care costs, some large employers recently have begun offering a package of health savings accounts that are broadly similar to MSAs, coupled with high-deductible policies, instead of offering traditional comprehensive insurance. Employers offering this package have concluded that doing so saves them money. The appeal of such packages is currently limited, however, because these health savings accounts lack the tax advantages of MSAs. Individuals cannot make tax-deductible contributions into them. Nor can they withdraw funds from these accounts upon retirement for *non*-medical purposes.

- That such accounts are beginning to be offered by large employers even though the accounts lack the tax attractions of MSAs suggests that if MSAs were made universally available and their tax-shelter benefits enlarged, as the House bill would do, substantial numbers of employers might begin offering MSAs and high-deductible policies.

- There is yet another reason that some employers might replace their current insurance arrangements with MSAs coupled with high-deductible policies. Under current law, employers cannot provide a different set of health benefits to higher-income executives than to lower-paid rank-and-file workers. To provide benefits that are attractive to their managers, firms generally must provide low-cost, comprehensive coverage to all of their workers. With MSAs, however, employers could provide less costly, less generous high-deductible plans tied to MSAs without worrying as much that such plans might encourage executives to seek jobs elsewhere that offer better health benefits. High-income managers and executives could use their MSAs as tax shelters by making substantial contributions to the MSAs on a tax-deductible basis. Since these individuals would have the ability to accumulate significant amounts in their MSAs — and the value of the MSA tax break is greatest for those in the top tax brackets — these tax benefits could make up for the increases in deductibles and other reductions in covered benefits that the executives could face under the high-deductible plans their employers might substitute for more comprehensive coverage. (For rank-and-file workers — and especially less healthy workers — such a change would generally be harmful; those workers would lose comprehensive low-deductible insurance and receive, in its place, a tax break of little value to them.)

4. **Finally, if this proposal becomes law, growing numbers of employers who do not initially seek to replace traditional comprehensive health insurance with MSAs may ultimately conclude they have little choice but to scale back comprehensive coverage significantly or eliminate it.**

    - If MSAs are broadly available, and if health care costs and thus the premium charges that employers pass through to their employees continue to rise, growing numbers of healthy individuals may withdraw from regular employer-based plans to escape the mounting charges and to take advantage of the tax breaks that MSAs provide. If this occurs, it is likely to induce growing numbers of employers at least to offer MSAs and high-deductible policies as an option.

    - But once substantial numbers of younger, healthier workers withdraw from an employer's comprehensive coverage plan — either to purchase a high-deductible policy and set up an MSA on their own or to participate in an employer-sponsored MSA/high-deductible package — a death spiral can set in for the employer's comprehensive coverage option. The withdrawal of younger and healthier workers from comprehensive insurance causes the employees left in traditional insurance to become a group that is less healthy on average and therefore more expensive to insure. As a consequence, such employers are likely to feel compelled either to raise to still-higher levels the premium co-payments their employees must make for

comprehensive insurance, thereby driving still more of the healthier employees out of comprehensive coverage, or to cease offering comprehensive coverage altogether.

In short, if the proposed MSA expansion is approved, there is high risk it will ultimately lead to comprehensive employer-based group insurance becoming less affordable and less widely available. That would cause more people, especially those who are older and sicker and most in need of traditional comprehensive insurance, to become underinsured or uninsured. These adverse effects are likely to outweigh substantially any modest gains in coverage that an MSA expansion otherwise might produce.

The remainder of this analysis examines these issues in more detail.

The MSA Demonstration and the Current MSA Rules

The bipartisan Health Insurance Portability and Accountability Act of 1996 established a demonstration to test and evaluate Medical Savings Accounts. The demonstration was designed to provide information about the effects of MSAs on workers, employers, and insurers and to do so without creating widespread, irreparable harm to the participants or the insurance market as a whole. Participation in the demonstration is limited to no more than 750,000 participants who are either employees of small businesses (businesses with 50 or fewer employees) or self-employed individuals. Participants must be enrolled in a high-deductible health insurance policy that meets certain statutory requirements and may take tax deductions for contributions they make to MSAs in amounts up to certain limits.[4] Other rules governing use of MSAs during the demonstration were designed to assure that these tax-advantaged savings accounts were used largely for the purpose of obtaining medical care and would not become a general-purpose tax shelter. The demonstration was originally scheduled to run through 2000 but was subsequently extended through December 31, 2003.

The 1996 legislation called for an evaluation by the General Accounting Office to determine the effects of MSAs on the insurance market and consumers. Among other issues, the evaluation was to study the extent to which MSAs fostered "adverse selection" — a situation in which younger and healthier individuals find MSAs financially advantageous and choose MSAs while older and less healthy individuals remain in traditional insurance. Such adverse selection would be highly problematic; if younger, healthier individuals (who generally have below-average medical costs) shift from traditional insurance to MSAs while older, less healthy individuals (who generally have above-average medical costs) remain in traditional insurance, the cost of traditional insurance necessarily rises, making it harder for employers and employees to afford. The GAO also was charged with studying the effect of MSAs on health care costs, including the cost of health insurance premiums. The goal was that Congress would be able to

[4] In tax year 2003, high-deductible plans must have deductibles of not less than $1,700 and not more than $2,500 for individual coverage, and not less than $3,350 nor more than $5,050 for family coverage. The maximum amount that can be contributed annually equals 65 percent of the health insurance policy's deductible amount for individual coverage, and 75 percent of the deductible amount for family coverage.

Is it Desirable to Shift Health Insurance to Less Comprehensive Coverage?

The House bill and the Administration's proposal should be seen as part of a broader agenda to shift health insurance coverage more to high-deductible plans with less comprehensive benefits. The Administration has criticized traditional, low-deductible health insurance that provides comprehensive benefits and limits co-payments to relatively modest amounts, arguing that consumers may unnecessarily use health-care services because they are too heavily shielded from the economic costs.[5]

Yet for most low- and middle-income individuals and families — especially those who are older and sicker — high deductibles, significant cost-sharing, and lack of coverage of essential medical services can lead to prohibitive out-of-pocket expenses that discourage access to medically necessary care. In addition, substantial premiums and cost-sharing have a disproportionate impact on lower-income families and individuals and their use of medical services when such services are needed, since these people have less disposable income available for out-of-pocket health-care expenses.

Recent studies by the Commonwealth Fund heighten these concerns. One study found that so-called "bare-bone" health plans — which generally are comparable to the high-deductible plans provided with MSAs — can leave some lower-wage individuals and families with catastrophic costs well in excess of their annual incomes.[6] Another Commonwealth Fund study also reported that older individuals who have purchased policies in the individual health insurance market similar to the plans provided with MSAs are *twice as likely* as comparable individuals with traditional employer-based coverage to fail to see a doctor when a medical problem develops or to skip medical tests or follow-up treatment.[7]

examine the results of the evaluation and, on the basis of those results, determine future policy regarding MSAs.

Relatively few individuals have chosen to use MSAs during the demonstration period. The IRS estimates that in tax year 2001, some 78,900 tax returns reflected MSA contributions.[8] As a result of this low utilization, the GAO has not been able to conduct a full evaluation of the effects of MSAs. Nevertheless, one portion of the GAO evaluation has been completed — a survey of insurers.

MSA proponents attribute the lack of popularity of MSAs during the demonstration period in part to various statutory safeguards included in the legislation that may have discouraged participation. Those rules were put in place to guard against spiraling premium costs due to adverse selection and to prevent abuse of MSAs as a general tax shelter. MSAs are likely to gain much greater popularity if MSAs are made universally available and the rules are altered substantially to allow more widespread use of the accounts as tax shelters, as would occur under the legislation.

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[5] Council of Economic Advisers, *Economic Report of the President*, February 2002, p. 63; Council of Economic Advisers, "Health Insurance Credits," February 13, 2002.

[6] Sherry Glied, Cathi Callahan, James Mays, and Jennifer Edwards, *Bare-Bones Health Plans: Are they Worth the Money?*, The Commonwealth Fund, May 2002.

[7] Elizabeth Simantov, Cathy Schoen, and Stephanie Bruegman, *Market Failure? Individual Insurance Markets for Americans*, Health Affairs, July/August 2001.

[8] IRS Announcement 2002-90 (October 7, 2002).

The Administration's MSA Proposal

The MSA proposal in the House bill and the Administration's fiscal year 2004 budget would effectively replace the MSA demonstration project with a policy that would make MSAs available to anyone who wants them. The proposal would:

- make MSAs permanent (the demonstration project currently is scheduled to expire at the end of 2003);
- open MSA participation to all individuals, eliminating the 750,000 cap on the number of people who can have MSAs and also permitting any individual to enroll in an MSA, not just those who are self-employed or in small businesses;
- increase the maximum amount that can be deposited each year in an MSA on a tax-deductible basis;[9]
- lower the minimum deductible amounts required of the high-deductible health insurance policies;[10] and
- allow both employers and employees to make contributions to MSAs in the same year. Currently, an individual who receives an employer contribution to an MSA is not allowed to make a deductible contribution in the same year.

These provisions would be likely to increase MSA participation quite substantially. The legislation also would likely lead to substantial expansion of the use of MSAs as tax shelters.

MSAs and Adverse Selection

MSA proponents usually argue that a number of uninsured taxpayers would gain health insurance if MSA use was more widespread.[11] The risk that significant numbers of currently insured individuals would *lose* their insurance if MSA use spreads widely as a result of adverse selection, however, is likely to outweigh any modest gains in coverage that may result from a MSA expansion.

Research by the RAND Corporation, the Urban Institute, and the American Academy of Actuaries indicates that the premiums for coverage under a traditional health insurance policy could at least double, depending on the degree of "adverse selection" that MSAs trigger in the

[9] The maximum amount that can be contributed would be increased to 100 percent of the deductible.

[10] The minimum deductible would be reduced to $1,000 for individual coverage and to $2,000 for family coverage. High-deductible plans also would be permitted to provide, without counting against the deductible, up to $100 in coverage for preventive services.

[11] In tax year 2001, about 70 percent of MSA participants reported they were previously uninsured. This figure appears anomalous. In prior years, only a minority of MSA participants reported they were previously uninsured. In tax year 2000, 40 percent of individuals with MSAs were previously uninsured and in tax year 1998, 24 percent of individuals participating in MSAs were previously uninsured. These are the tax years for which data is available.

insurance market.[12] Moreover, evidence from the survey of insurers that was conducted in conjunction with the MSA demonstration project suggests that insurance companies establish premiums for MSAs based on the assumption that adverse selection will take place. According to the survey report, "Insurers view high deductible plan enrollees as presenting a lower claims risk than enrollees in traditional low deductible plans....Insurers expect relatively better health status and lower service utilization by enrollees selecting high deductible plans and price their products accordingly."[13]

At the higher premium rates that would result for traditional insurance if MSA use becomes widespread, it is likely that significant numbers of employers either would be unwilling to continue offering their employees traditional insurance or would feel compelled to increase the share of the premium costs that employees must bear, which could make traditional insurance unaffordable for some workers. Rapidly increasing health care costs and the current economic slump already have moved some employers to offer less comprehensive health insurance coverage to their workers and/or increase the portion of the cost of insurance that their workers must shoulder. A Commonwealth Fund survey found that 41 percent of workers reported being charged increased employee premiums in 2002, receiving fewer benefits under their policies, or being required to make larger co-payments for services used than the year before.[14]

Moreover, as a result of rising health care costs, an increasing number of larger firms already are starting to offer a package that combines health accounts similar to MSAs (except that they lack the tax advantages of MSAs) with high-deductible insurance policies, in lieu of offering traditional insurance.[15] As with MSAs, these health accounts can be used to help defray the higher out-of-pocket medical costs that are associated with high-deductible plans. The employers that have instituted this policy generally have concluded that the contributions they make to these health accounts and high-deductible plans cost them *less* than continuing to subsidize a substantial percentage of the premium costs of traditional low-deductible, comprehensive insurance.

Today, employees who are offered these health accounts *cannot* make tax-deductible contributions to them; only their employers can contribute funds to these health accounts. In

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[12] Emmett B. Keeler, et. al., "Can Medical Savings Accounts for the Nonelderly Reduce Health Care Costs?" Journal of the American Medical Association, June 5, 1996, p. 1666-71; Len M. Nichols, et. al., *Tax-Preferred Medical Savings Accounts and Catastrophic Health Insurance Plans: A Numerical Analysis of Winners and Losers*, The Urban Institute, April 1996; and American Academy of Actuaries, *Medical Savings Accounts: Cost Implications and Design Issues*, May 1995.

[13] General Accounting Office, *Medical Savings Accounts: Results from Surveys of Insurers*, December 31, 1998, GAO/HEHS-99-34, Appendix, p.14.

[14] Jennifer Edwards, Michelle Doty and Cathy Schoen, *The Erosion of Employer-Based Health Coverage and the Threat to Workers' Health Care*, The Commonwealth Fund, August 2002.

[15] Kaiser Family Foundation and Health Research and Educational Trust, *Employer Health Benefits: 2002 Annual Survey*, September 2002; Melody Simmons, "It's Your Money, You Decide," Washington Post. October 29, 2002; Albert B. Crenshaw, "Proposed Health Accounts May Give Employees More Control," Washington Post, July 7, 2002; Milt Freudenheim, "A New Health Plan May Raise Expenses for Sickest Workers," New York Times, December 5, 2001; Employee Benefit Research Institute and Consumer Health Educational Council, *Consumer-Driven Health Benefits: A Continuing Evolution*, 2002.

addition, employees are not permitted to withdraw these funds upon retirement for non-medical purposes. In these respects, these health accounts are less attractive than MSAs. They lack MSAs' tax advantages.

But this suggests that if MSAs were made broadly available and their tax-shelter benefits were enlarged, as the Administration has proposed, their use by employers might become quite widespread. MSAs would add substantial tax-shelter advantages to the type of health accounts that some firms already are starting to offer. The House bill and the Administration's proposal likely would induce a considerably larger number of firms to pursue this course and to begin offering MSAs and high-deductible plans. If that occurs, MSA use is likely to become much more widespread, and adverse selection more prevalent.

The higher premiums for traditional insurance that would likely result from the adverse selection this would engender would accelerate the movement from traditional health insurance to high-deductible, less-comprehensive coverage. This should be of concern: a recent study from the Employee Benefit Research Institute concludes that the loss of comprehensive coverage would leave many people who need significant amounts of health care, such as individuals with chronic conditions, little recourse but to become underinsured or uninsured.[16]

Use of MSAs as Tax Shelters

MSAs bear similarities to tax-deductible Individual Retirement Accounts: contributions to MSAs are deductible from income; the contributions can be left in the accounts for years and invested in stocks, bonds, or similar assets; and tax is deferred on the amounts that the accounts earn (i.e., earnings on an MSA account compound free of tax). Furthermore, while deposits and earnings are never taxed if MSA funds are used to pay medical costs, the tax advantages of MSAs can be substantial even if the funds in the accounts are later withdrawn and used primarily or exclusively for non-medical purposes. If deposits are held until retirement age, there is no penalty for withdrawal for non-medical purposes. Even if funds are withdrawn for non-medical purposes *before* retirement age, there are a number of circumstances under which the value of the tax-free compounding of the deposits over a number of years would outweigh the penalty that must be paid for a non-medical withdrawal.

MSAs do, however, differ from IRAs in a key respect — there are no income eligibility limits on MSAs that prevent wealthy people from using them as tax shelters.[17] As a result, opening up MSAs to all individuals and increasing the amount of tax-deductible contributions that may be made to them, as the House bill and the Administration's proposal would do, would

[16] Laura Tollen and Robert Crane, *A Temporary Fix? Implications of the Move Away from Comprehensive Health Benefits*, Employee Benefit Research Institute, April 2002.

[17] In 2003, people covered by a retirement plan through their place of employment may make tax-deductible contributions to IRAs if their income is below $70,000 for married filers and $50,000 for most other filers. These levels are scheduled to rise to $100,000 for married filers and $60,000 for singles filers by 2007. The income limits are higher for "Roth IRAs": $160,000 for married filers and $110,000 for most other filers. (Under Roth IRAs, contributions are not tax deductible, but withdrawals at retirement are tax free.)

enable high-income taxpayers who cannot use IRAs because of the income limits to begin using MSAs as significant tax shelters.

When the MSA demonstration was starting, a number of financial experts pointed out the possibilities for use of the accounts as tax shelters for those with high incomes.[18] A *New York Times* article profiled a relatively well-off MSA holder who chose to pay medical expenses with other funds, leaving his MSA deposits to grow tax-free.[19]

The survey of insurers conducted under contract with the GAO indicates that the MSA market has indeed developed in a manner that reflects the attractiveness of MSAs as tax shelters to affluent individuals. The survey reported on "insurers' perceptions that MSA enrollees are using their accounts primarily as tax-sheltered savings vehicles rather than as sources of tax-sheltered funds for paying medical expenses."[20] The survey also noted that MSA insurers reported that they are targeting highly paid professionals and other types of more affluent individuals (like farmers and ranchers and people in partnership firms, such as legal and medical practices) in marketing MSAs.

Making MSAs more widely available would increase their use as tax shelters, especially by affluent individuals who would benefit the most from the tax shelters and who tend to be in better-than-average health.

MSAs and Employer-Based Coverage

Over time, "adverse selection" would drive up premiums and probably result in more employers concluding they could no longer afford to offer traditional health insurance. Making MSAs widely available is likely to result in more employers offering MSAs and high-deductible health insurance policies in lieu of more comprehensive group policies.

Employers have traditionally been concerned about their ability to recruit and retain higher income managers if the health benefits they offer are not comprehensive. The expanded availability of MSAs could change that. The individuals who would be least affected by employers switching to MSAs and high-deductible policies would be higher-income taxpayers who could afford to contribute a portion of their wages on a tax-deferred basis to MSAs and who would benefit most from the MSA tax break because they are in a high tax bracket. For these individuals, the tax shelter benefits from MSAs would tend to outweigh the greater out-of-pocket costs associated with high-deductible plans, making the MSA/high-deductible package an attractive one.

The legislation also includes changes that would vitiate current MSA rules that prevent employers from setting up MSAs in a manner that primarily benefits highly paid executives and

[18] Vivian Marino, Associated Press release, August 15, 1997.

[19] Margaret O. Kirk, "Medical Accounts: Mixed Reviews," *New York Times*, July 5, 1998.

[20] General Accounting Office.

effectively discriminates against lower-paid employees. Under the current MSA rules, deposits can be made in an MSA account *either* by an employer or an individual, but not by both in the same year. Current rules also include nondiscrimination provisions that require employers to make comparable contributions to MSA accounts for all participating employees.

The legislation would change how MSAs operate by allowing *both* employees and employers to make deposits in an MSA in the same year. That would render the nondiscrimination rules largely meaningless. An employer could replace traditional insurance with MSAs and high-deductible policies and make small deposits in the MSA accounts of all employees. Higher-income employees could then add substantial funds to their accounts on a tax-deferred basis to pay for the increased cost-sharing and lesser benefits provided under the high-deductible plan and to take advantage of the tax-sheltering opportunities that MSAs provide. Most lower-paid staff, by contrast, would not be able to afford substantial contributions. As a result, older and sicker workers who are not affluent could face serious obstacles in accessing essential health care services.

Conclusion

The MSA provisions of the House-passed bill, which are virtually identical to the Administration's MSA expansion proposal, would both make MSAs much more widely available and make them more attractive as tax shelters. This would likely lead to much more widespread use of MSAs by healthy, younger individuals, especially more affluent ones.

Because it could lead to much more widespread MSA use, the proposed MSA expansion risks causing extensive "adverse selection" and significantly weakening comprehensive employer-based insurance. The shrinkage of comprehensive employer-based coverage could cause serious problems for many health care consumers, particularly older and sicker workers.

The proposal also would be likely to lead to greater abuse of MSAs as tax shelters. Overall, the proposals to make MSAs more widely available and more lucrative as tax breaks would likely worsen the health insurance status of older and sicker Americans, while reducing federal revenues and adding to the deficit.

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