

BRIEF ANALYSIS

No. 208

For immediate release:

Wednesday, July 3, 1996

The Medicare Program: The Need for Radical Surgery

Medicare is going bankrupt. That's the conclusion of the Medicare Board of Trustees in its most recent actuarial report on the financial status of the Health Insurance Trust Fund, the (Medicare Part A) fund that pays hospital bills.

Last year, the trustees estimated that the Medicare trust fund had sufficient reserves to remain solvent only until the year 2002, resulting in a national debate about the future of the Medicare program and how to reform it. That debate degenerated into partisan wrangling, however.

The findings of this year's report are even bleaker: as the figure shows, Medicare's financial demise is only a few short years away. If Congress doesn't act soon, the Medicare trust fund will be unable to pay the medical bills of our senior citizens by the year 2000, and possibly sooner.

The Democrats' Cure: Shifting Costs. Confronted with this financial collapse, Democrats have responded by proposing to shift home health care expenses reimbursed under Medicare Part A to Medicare Part B — the Supplemental Medical Insurance (SMI) program that pays physicians' fees and outpatient service charges.

Although it is a voluntary program that charges a monthly premium (which is deducted from the recipient's Social Security check), 84 percent of Medicare's 36 million beneficiaries enroll in Part B. The reason? It is heavily subsidized and no private insurance plan can compete with it. The current monthly premium of \$42.50 covers only 25 percent of the program's costs — down from last year, when beneficiaries paid nearly a third of the costs. The federal government pays the remainder out of general revenues.

Shifting expenses covered under Part A to Part B would lower Part A expenditures, thus delaying the

program's financial collapse. However, the move would increase Part B expenditures. Since seniors pay a percentage of Part B's total cost, and since taxpayers fund the remainder, this means higher monthly premiums for seniors and higher taxes for the general public.

A Better Solution: Patient Choice. A better way to hold down Medicare's exploding costs is to permit Medicare beneficiaries the option of choosing a private-sector plan. Private-sector health plans have been very successful in slowing the growth of health care spending. For example, health insurance premiums for workers

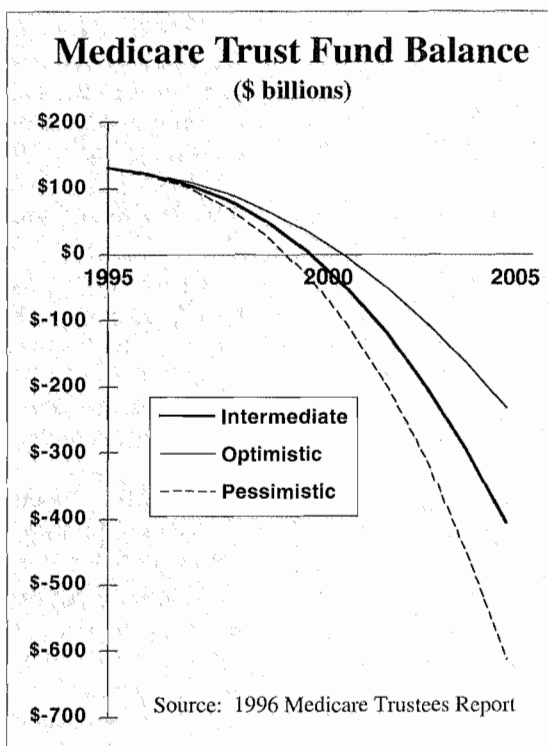
have been growing a modest 2 to 5 percent per year, while Medicare has been growing by more than 10 percent annually. Thus, giving seniors the ability to choose between a wide range of private-sector plans could also reduce total Medicare spending.

Under current law, some Medicare beneficiaries already have the option of taking 95 percent of Medicare's average annual per person expenditure and transferring that to a Health Maintenance Organization (HMO). In return, the HMO promises to provide the senior with comprehensive health care services. However, only 10 percent of Medicare enrollees have chosen this private-sector option, in part because HMOs restrict patients' ability to choose their own physician. Both Re-

publicans and Democrats want to expand the options available to seniors in hopes of improving quality and decreasing costs.

The Republicans' Private-Sector Options. The essence of the Republican proposal is to shift power and control over Medicare dollars away from the government, the hospitals and the doctors to the elderly themselves. The key features of the plan are:

- Each senior would have the freedom to choose from a full range of private health plans, rather than remaining under traditional Medicare.



- Options include HMOs, Medical Savings Accounts (MSAs), traditional fee-for-service insurance, preferred provider networks, provider service networks (doctors and hospitals in an area organized to provide health coverage directly) and plans offered by associations such as AARP, unions or employers.
- Any senior could stay in the current Medicare system, forgoing the private options entirely.

The private plans would be required to provide at least the same benefits as Medicare and to accept all seniors who choose them during an annual open enrollment period, regardless of health condition. Moreover:

- The amount the government pays to the private plans would vary, depending on the senior's age, geographic location and certain health factors; plans would get more for older and sicker enrollees and less for younger and healthier enrollees.
- If a chosen plan cost less than the government paid, the senior could keep the difference, up to the equivalent of the Medicare Part B premium, which would have been around \$600 per person in 1996.
- The amounts the government would pay for these private options could grow no faster than the targets set in the federal budget. Thus the targets would be automatically met to the extent that seniors chose the private options.

The Democrats' Private-Sector Options. The Democrats' proposal is less comprehensive than the Republicans' and would limit seniors' choice to managed care plans such as HMOs, preferred provider organizations (PPOs) and "point of service" (POS) plans. They would exclude what is likely to be the most cost-effective option for most seniors: Medical Savings Accounts.

Slowing the Growth of Medicare Spending. Both Republicans and Democrats are proposing to slow the rate of growth in Medicare spending. When the Medicare reform debate began in early 1995, Republicans believed that giving seniors private-sector options would result in massive savings to the program, thus averting a financial collapse. However, the Congressional Budget Office (CBO) refused to consider any savings from the plans in budget projections. If the Republicans wanted CBO confirmation of Medicare savings for purposes of balancing the federal budget, the Republicans would have to place a limit on how much Medicare would be permitted to grow each year.

Currently, Republicans are proposing to reduce the growth of Medicare by \$158 billion over six years — \$114 billion from Part A and \$44 billion from Part B. Democrats are proposing a growth reduction of \$116 billion — with only \$72 billion coming from Part A and the same \$44 billion from Part B. Both proposals intend to reach their goals by reductions in provider and hospital reimbursements. However, cuts in the Republican plan are a "fall back" provision, meaning that reimbursements will be cut only if the attempt to encourage private-sector options fails to slow the growth in spending by the targeted amount.

The HMO Prescription: A Cure Worse than the Disease. While HMOs should be an option for seniors to choose, putting too much pressure on seniors to leave traditional Medicare and join an HMO could be politically disastrous. That's because new evidence indicates that HMOs restrict patient choice in ways that may harm their health and undermine the doctor-patient relationship.

Critics of managed care have long contended that HMOs limit patient choices and often preclude patients from seeing specialists, obtaining diagnostic tests and getting other needed health care. Now, a new survey of sick people by scholars at the Harvard School of Public Health finds that managed care patients are almost twice as likely to complain that they are not getting treatment they and their doctors think is necessary and about 50 percent more likely to be unable to see a specialist or to get needed diagnostic tests.

What's Needed: Radical Surgery. Medicare is not just sick, its condition is fatal. Band-Aids won't solve the problem. Unless Congress does radical surgery it will never survive. While giving patients the ability to choose a private-sector option is a step in the right direction, Congress should go further: let workers create their own medical IRA by permitting them to redirect their 2.9 percent Medicare payroll tax to an individual savings account. These accounts would grow over the employee's working life and could be used for health care after retirement.

While reforms offered by the Republicans and Democrats might avert Medicare's immediate bankruptcy, what is needed is a long-term solution. Replacing Medicare with a fully funded private program is the only long-term solution.

This Brief Analysis was prepared by NCPA Vice President Merrill Matthews Jr.