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FEHBP CONTROLS COSTS AGAIN: MORE LESSONS FOR MEDICARE REFORMERS

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While Members of Congress wrestle with the problem of how to fix the nearly bankrupt Medicare program, they will not be worrying about the future of their own health care system. Even those Members planning to retire next year have no cause for concern. The reason: Beginning on November 13 and running through December 11 of this year, these same Members of Congress, along with millions of federal workers, retirees, and their dependents, will have a unique opportunity to pick the private insurance plan and combination of health benefits they think best for them for next year. Retiring members will continue to enjoy this privilege. They can do this because they are enrolled in the Federal Employees Health Benefits Program (FEHBP), the popular, 35-year-old, consumer-driven system with almost 400 private health plans competing nationwide.

✓ **Broad Choice.** Unlike Medicare beneficiaries, who are locked into an inflexible government-standardized benefits package, these special Americans enjoy a broad range of consumer choice practically denied to all other Americans. For these enrollees in the FEHBP, there is even more good news: Not only can they pick and choose from a wide variety of private plans, with a variety of prices and benefits, but they also can pocket the savings that result from wise choices.

✓ **Cost Control.** While Medicare costs are soaring at 10.5 percent per year, the United States Office of Personnel Management (OPM), the federal agency that runs the FEHBP, recently trumpeted to Members of Congress and congressional retirees the good news that next year they can look forward to insignificant premium increases, and that many will see no premium increases at all. "Employees and retirees shopping for health care coverage in the Federal Employees Health Benefits Program for 1996," declares OPM, "will find a total average premium increase of only four tenths of one percent, compared to an average private sector premium increase of more than six percent over a comparable period."[1] For this year, premiums actually declined on average by 3.3 percent, and in 1994 they rose just 3 percent. FYI#64/95

✓ **Government Help.** Under current law, the government contributes about 72 percent of the cost of the premium of any private plan that Members of Congress and congressional and federal retirees choose. If, in any given year, these consumers wish to keep their private plans, they do not

1 OPM news release, "1996 Federal Employees Health Benefits Program Open Season Highlights," September 11, 1995.

have to do anything. If they wish to change their plans and get better value for their dollars, they may do so. Members of Congress and federal workers and retirees may wish to remain in more expensive plans because they think that a richer set of benefits or a more attractive combination of benefits is worth the cost to them. Next year, according to OPM, federal employees and retirees will see an average biweekly increase of just 44 cents for self-only coverage and only $2.25 for family health insurance coverage. Over 25 percent of enrollees will not experience any rate increase in 1996.[2]

✓ **Solid Information.** The federal government assists Members of Congress and federal workers and retirees with a financial contribution toward the purchase of their plan and with unbiased information on various plan offerings. This information is supplemented by helpful information from private-sector organizations, unions, and employee associations on the best plans available to workers, retirees, and their families in terms of value, quality, and price. For congressional and federal retirees, the National Association of Retired Federal Employees (NARFE), a major organization representing over 500,000 active and retired personnel, suggests the best plans for those needing specialized medical services. *Washington Consumers Checkbook* even rates plans according to comprehensive patient surveys to help FEHBP enrollees pick plans.

While reforming Medicare, Members of Congress should keep in mind key lessons from their own experience in the FEHBP.

LESSON #1: Consumer choice and competition control costs, even in an insurance pool comprised of older workers and a disproportionate number of retirees. Older workers and retirees cost significantly more to cover than younger, more active employees. Surprisingly, the FEHBP is not an ideal insurance pool, with a large number of younger, healthier workers cross-subsidizing a much smaller group of older workers and retired personnel. Instead, the federal workforce is significantly older than the private-sector workforce; the average federal worker is 43.8 years of age, while the average private-sector worker is 37.7 years of age. Moreover, the ratio of retirees to active workers has increased steadily over the past several years. And while private firms are reducing and even eliminating retiree health benefits, approximately 40 percent of all subscribers in the FEHBP are retirees,[3] helping to make the total insurance pool itself progressively older. Most federal retirees today have access to the Medicare system as a result of changes in the Social Security law in 1983, but approximately 200,000 still rely on FEHBP plans as their primary health insurance. Nonetheless, even retirees with Medicare coverage are more costly to the system than active federal workers.

The FEHBP has demonstrated a remarkable success in controlling costs. While average premium increases next year will be only four tenths of one percent, FEHBP enrollees last year experienced an average annual decrease of 3.3 percent.

LESSON #2: Federal workers and retirees would have enjoyed even greater personal savings in the FEHBP if Congress had guaranteed federal workers a defined contribution, indexed to inflation, instead of relying on the current government formula. Today, the federal government contributes to the cost of each private plan chosen by Members of Congress, federal workers, and retirees. The maximum dollar amount contributed by the federal government is set legally by a formula which requires OPM to calculate the government contribution on the basis of the average premium of the six largest plans in the program: the "Big Six" formula. Current law also specifies that the federal government can contribute no more than 75 percent of

2 *Ibid.*
3 Carolyn Pemberton and Deborah Holmes, eds., *EBRI Databook on Employee Benefits* (Washington, D.C.: Employee Benefit Research Institute, 1995), p. 278.

the premium cost of any given plan. This means that, in any given year, the government's contribution will vary, depending upon the OPM staff's negotiating skills and the annual premium performance of the six largest plans in the program. One proposal advanced by Heritage scholars to reform the FEHBP, and also incorporated in this year's Congressional Budget Resolution, is to replace the Big Six formula with a clearly defined annual dollar amount for individual and family coverage.[4] This is similar to the voucher proposal for Medicare now being considered by Congress.

Future increases in that dollar amount would be based on increases in the Consumer Price Index (CPI). Private plans competing directly for the dollars of federal workers and retirees thus would have a powerful incentive to offer attractive packages of benefits at a price at or even below the fixed dollar amount, thereby reducing the out-of-pocket costs to workers and retirees and increasing their savings even more. Competition among private insurance plans would intensify, and federal workers would get to pocket any difference between the defined contribution and the actual price of a plan. With the elimination of the existing 75 percent cap on the government contribution, workers who picked lower cost plans would not be penalized by any reduction in the dollar value of the government's contribution, and those who picked higher cost plans would not be rewarded by the government.

Lost Compensation. If the defined contribution rule had been in effect in recent years, federal workers and retirees generally would have done better financially than they do under the current formula. In any case where FEHBP's premium performance dipped below the Consumer Price Index beyond any other savings achieved through careful choice of plan, federal workers and retirees would have experienced a gain in overall compensation. For example, under the current formula, the maximum government contribution for 1996 will be $3,432.26 for family coverage and $1,599.26 for single coverage. Under the 1996 Congressional Budget Resolution establishing a defined contribution, the federal government's contribution would be $3,547 for family coverage and $1,587 for single coverage.[5]

Under such a defined contribution arrangement, federal workers and retirees would be able to pocket the difference between the defined contribution and the cost of any plan. Given recent premium performance, they would have fared better under a clearly defined dollar contribution over three of the last five years:[6]

GOVERNMENT CONTRIBUTION TO FEHBP: ACTUAL AND WITH A DEFINED CONTRIBUTION

	Current "Big Six" System				CPI-U Adjusted Defined Contribution System			
	biweekly		annual		biweekly		annual	
	single	*family*	*single*	*family*	single	family	single	family
1992	$60.50	$130.58	$1573.00	$3395.08	$60.95	$131.08	$1584.61	$3408.17
1993	$64.43	$139.60	$1675.18	$3629.60	$62.77	$135.02	$1632.15	$3510.42
1994	$66.20	$141.42	$1721.20	$3676.92	$64.66	$139.07	$1681.11	$3615.73
1995	$61.38	$134.18	$1595.88	$3488.68	$66.34	$142.68	$1724.82	$3709.74
1996	$61.51	$132.01	$1599.26	$3432.26	$68.53	$147.39	$1781.74	$3832.16

1996 estimates are based on the CBO estimate for CPI-U of 3.3%.

4 See Scott A. Hodge, ed., *Rolling Back Government: A Budget Plan to Rebuild America* (Washington, D.C.: The Heritage Foundation, 1995), pp. 225-226.

5 Summary of Conference Agreement Major Provisions, Congressional Budget Resolution for Fiscal Years 1996-2002, Updated June 26, 1995, p. 2.

6 Calculations for the annual government contribution were based on multiplication of the maximum bi-weekly government contributions by 26, reflecting the 26 annual pay periods for federal employees. Figures for the CPI-U based defined contribution system were calculated by John S. Barry, Economics Research Assistant at The Heritage Foundation.

Such a change in FEHBP financing to establish clear and predictable increases in the government contribution would allow federal workers, retirees, and their families to take full advantage of any positive changes in the competitive market for insurance.

Moving from a defined benefits to a defined contribution system would be a good deal for federal workers and retirees. Such a change also makes sense for the Medicare system. The FEHBP shows that giving enrollees the right to choose plans in a comprehensive market forces insurers to improve value for money, not simply to cut costs.