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URGENT ACTION NEEDED ON MEDICARE

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The latest annual report of the Medicare Board of Trustees underscores the severe financial plight of the program and the urgent need for structural reform. The six trustees, who include three Clinton Administration Cabinet secretaries, make clear that no amount of fine-tuning can stave off disaster. The report indicates that the only way to assure Medicare's ability to deliver adequate health care to most of today's senior citizens, let alone the next generation of elderly Americans, is to overhaul the program now so that it can deliver better care for less money.

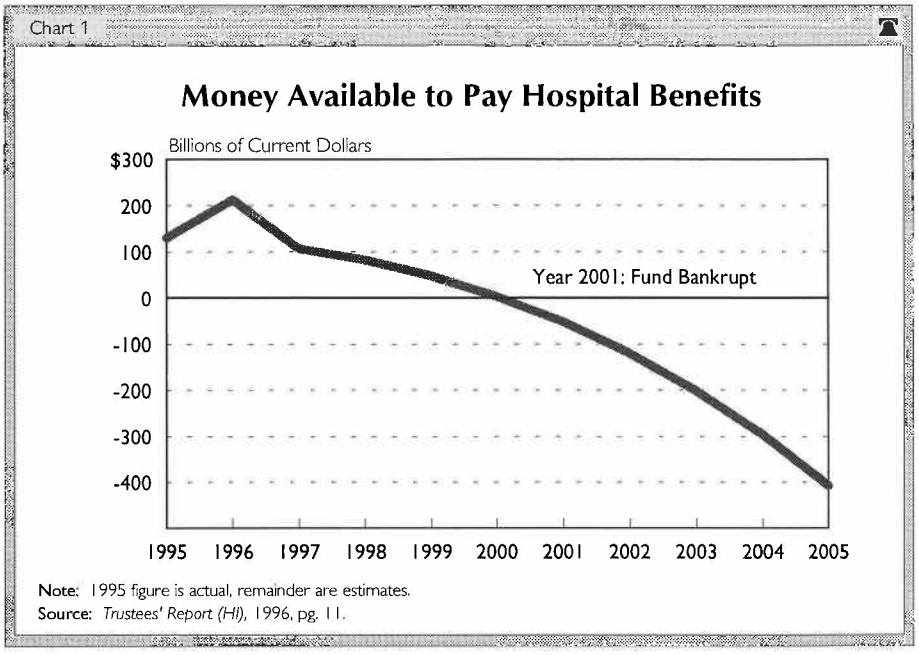
Most of the recent media attention given to the report has focused on the trustees' assessment of the Hospital Insurance (HI) Trust Fund, also known as Part A. The trust fund is like a savings account, where the income is payroll tax revenue and the outlays pay for services. The problem is that for a number of reasons, most significantly the aging of the baby-boom generation, the trust fund is being hit by a financing windshear, already causing outlays to exceed income and exhausting all reserves by 2001. In other words, the fund in 2002 literally would have no money to pay promised benefits. Thereafter, for at least the next 70 years (the limit of the trustees' projections), the cost of continuing services would continue to exceed program income.

Absent any reform, Medicare can continue after 2001 only if it drastically cuts services or tries to keep the HI program afloat with tax increases. But the cost of a bailout would be staggering. The report indicates that the cumulative deficit in the trust fund (that is, the extra money needed to maintain services) would be over $400 billion by 2005. In that year alone, outlays would exceed income by over $100 billion, and the red ink would be accelerating annually. So just to continue hospital services until 2005, the bailout cost to the average American household would be about $4,000 in new taxes. As the trustees conclude, with classic understatement, "The HI program remains severely out of balance."

But that is just Part A. Part B of Medicare, which pays for physician and other services, is financed only partly by premiums (which cover about 30 percent of program costs), with the rest financed by general revenues. The level of taxpayer subsidy has nothing to do with the beneficiary's income—elderly millionaires get the same subsidy as the poor. Under current law, say the trustees, taxpayers will have to cover 84 percent of Part B costs by 2005 and an increasing proportion thereafter. According to the trustees' figures, the cumulative taxpayer subsidy between 1996 and 2005 alone will be $950 billion, or roughly $10,000 in taxes for the average American household. The figures for succeeding decades will be even larger.

Taking the two parts of Medicare together, to keep the program afloat just until 2005 without reforms will take about $14,000 per household in taxes.

Chart 1



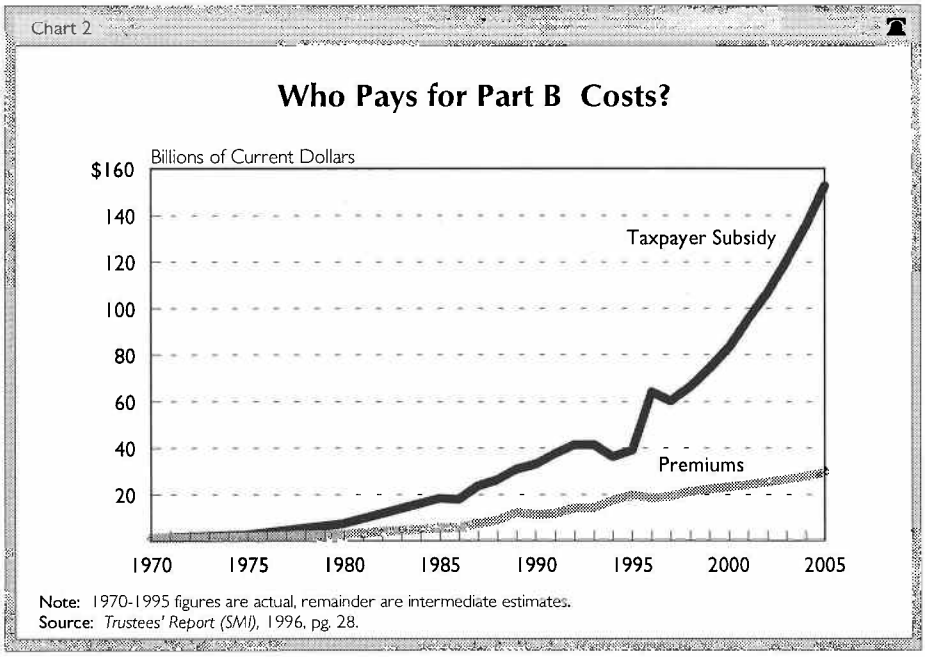
Note: 1995 figure is actual, remainder are estimates.
Source: *Trustees' Report (HI)*, 1996, pg. 11.

Unfortunately, this stark picture prompts the trustees to call for "the earliest possible enactment of legislation" only to delay bankruptcy for a few years, not to address the long-term problem. Instead, they call for a national commission to recommend long-term solutions.

Such a commission would be a serious mistake. Rather than encourage serious public discussion of the tough choices that must be faced, it would allow nervous politicians to believe they can avoid the issue of Medicare for a few more years. But by then the choices would be more limited and the necessary action more drastic.

Advocates of a commission point to previous examples of supposedly successful commissions in making the case for a Medicare commission. Most often they cite the 1982 Social Security commission and the recent panel on military base closures. But the experience of commissions intended to produce legislation is that they are successful in only two situations: first, when only a relatively small mid-course correction is needed in the funding of a sensitive program to keep it in operation for many years (the Social Security commission), or second, when there is almost unanimous agreement on what needs to be done and the commission merely provides political protection (base closing).

Chart 2



Note: 1970-1995 figures are actual, remainder are intermediate estimates.
Source: *Trustees' Report (SMI)*, 1996, pg. 28.

Medicare fits into neither of these categories. The problem is not small and short-term: It is massive and structural. And there is no consensus on what needs to be done. To deal with Medicare, major and controversial decisions will have to be made concerning the nature of the entitlement, the benefits, and the role of the taxpayer. These already have been discussed at length on Capitol Hill. In fact, legislative decisions were taken last year, only to be vetoed by President Clinton. All a commission can do, in effect, is take a year or so to put the options already known into a single binder and deliver them back to Capitol Hill. But Congress and the President will still have to make the

tough choices—a commission would not render them any easier. With the program so close to collapse, it would be much wiser for the elected government to begin making those decisions today, preferably with the President as an active partner.

To achieve long-term stability in Medicare, three broad changes are needed to encourage much greater efficiency by giving much more economic control and more sensible incentives to the elderly. The bill Congress enacted last year would have begun this reform, but was vetoed. Specifically, Congress and the White House should:

- ✓ **Turn Medicare into a defined contribution program.** Medicare currently promises a set of specific benefits, rather than a certain degree of assistance to seniors to purchase the benefits they want. Moving to a defined contribution system would give the elderly much greater choice and an incentive to seek better value for money.
- ✓ **Open up new plan choices for the elderly.** In today's Medicare, benefits are designed and priced in Washington and updated only slowly, if at all, after months or years of intense debate and lobbying in Washington. That is why the elderly are still waiting for the kind of routine drug benefits, or service options, that are available in almost any standard private plan—or to retired federal workers in the Federal Employees Health Benefits Program (FEHBP). Thus, allowing seniors the right to choose from a wide range of plans and benefit packages is needed to modernize coverage. It also is needed to spur competition between plans to provide the best value for money for seniors.
- ✓ **Reduce the Part B subsidy for those who do not need it.** Part B is not a social insurance program. It is a heavily subsidized, optional, government-run physician insurance program. Rich elderly Americans receive the same subsidy as seniors who rely entirely on their Social Security checks. It is time for Congress to rein in the unwarranted taxpayer-funded subsidy for those who do not need it to afford health care.

The Medicare trustees' report is grim reading. It refutes utterly the naïve idea that only a little fine-tuning is needed for the program to exist for the next generation of elderly Americans. The report makes clear that there are only three choices available: massive tax increases, draconian benefit cuts, or structural reforms to enable the program to deliver health care at less cost. Obviously, only the third choice makes any sense. The quicker Congress and the White House begin those reforms, the less painful they will be.