The Heritage Foundation
Executive Memorandum

No. 820 June 14, 2002

CRITICAL REFORM MUST ACCOMPANY A MEDICARE DRUG BENEFIT

ROBERT E. MOFFIT, PH.D.

Congress will soon have an opportunity to make serious structural improvements in Medicare. These changes would enhance the role of market forces and give seniors the right to choose better health plans and access to prescription drug coverage. The goal should be to transform Medicare so that it resembles the superior Federal Employees Health Benefits Program (FEHBP) that covers Members of Congress, the White House, and millions of federal workers and retirees and their families.

Congress should begin taking incremental reform steps this year to put Medicare on a solid framework before the 77 million baby boomers begin retiring in nine years. Under no circumstances should Congress graft a new drug benefit of unknown cost onto the existing program without making serious structural reforms. Such a path would exacerbate Medicare's growing financial pressures and managerial problems.

Essential Components of Reform. Any legislative proposal that reaches the President's desk this year should address Medicare's crucial structural problems. But even without comprehensive reform, Congress could start transforming Medicare into a modern health care program characterized by personal choice, market competition, light regulation, and administrative flexibility. To that end, Congress should:

- **Create an agency to administer a competitive system that includes Medicare+Choice.** This agency could be created within the Department of Health and Human Services and should function much as the Office of Personnel Management (OPM) does in administering the FEHBP. It could negotiate rates and benefits with private plans, set basic benefit and fiscal solvency standards for competing plans, enforce consumer protections, provide comparative information on plans, develop risk adjustment mechanisms to reduce adverse selection, and set annual government premium contributions based on free-market conditions of supply and demand. Jurisdiction for Medicare+Choice should be transferred to this agency from the Centers for Medicare and Medicaid Services (CMS, formerly HCFA), which should confine itself to running traditional Medicare. The new agency could administer a prescription drug benefit in a fashion compatible with overall Medicare reform.
- **Stabilize Medicare+Choice by changing its payment system.** More than 100 plans have dropped out of the excessively regulated Medicare+Choice program, and more than 2 million

Produced by the
Domestic Policy Studies
Department

Published by
The Heritage Foundation
214 Massachusetts Ave., NE
Washington, D.C.
20002–4999
(202) 546-4400
http://www.heritage.org

This paper, in its entirety, can be found at: *www.heritage.org/library/execmemo/em820.html*

seniors have lost their choice of private coverage. Though health care costs have risen steadily over the past few years, Medicare's administrative pricing has capped payments at 2 percent. Congress should substitute a new payment formula based on the average premiums of competing health plans, just as OPM does for the FEHBP. Government contributions to plans should reflect real market conditions, and seniors should benefit from intense plan competition for their dollars.

- **Allow new retirees to take their health plans into retirement.** At a date certain, Congress could allow new retirees, when they turn 65, to choose whether to enroll in the old Medicare program or to bring their private plan into retirement, with a government contribution to offset its cost. This would create seamless continuity of coverage and care for retirees and also change the dynamics of the program. New private plans would fall under the new market-friendly administering agency's jurisdiction. With a gradual phase-in of reforms, Congress could monitor progress and allow for adjustments in financing and administration.
- **Craft a prescription drug benefit compatible with market-based reform.** In the FEHBP, drugs are fully integrated into the range of plan benefits and paid for through a single premium. The original Breaux–Thomas reform proposal would make low-income seniors eligible for additional government subsidies to offset prescription drug costs. Absent such reform, Congress could target assistance to low-income seniors who lack access to drug coverage by giving them a prescription drug card (debit card) plugged into a federally subsidized prescription drug account, as proposed by Galen Institute and American Enterprise Institute health policy analysts. With an initial deposit of between $600 and $800 per year, the account could be rolled over from year to year and include a catastrophic provision for high drug costs. Such a structure would guarantee needy seniors quick access to coverage, facilitate the growth of a competitive market, and maximize personal freedom. It would also be compatible with comprehensive reform based on patient choice and market competition.

  Because roughly one-third of all seniors get their drug coverage through a former employer's health plan, a badly designed drug benefit that displaces the existing private market and encourages employers to dump retirees from private plans into a government drug program would hurt millions of seniors and taxpayers. Without serious structural reform, adding a drug benefit also would worsen Medicare's financial condition, leading to a reduction in the availability of drugs for seniors. Since 1999, projected costs of congressional drug proposals have risen from an additional $60 billion to $600 billion over 10 years. Dr. Mark McClellan of the President's Council of Economic Advisers testified before the House Commerce Subcommittee on Health in April that using Medicare trust fund surpluses to finance a $750 billion proposal would force the fund to start losing money as early as 2008 and to become insolvent in 2016, when many baby boomers would be well into retirement.

- **Roll back the regulatory excesses that plague the existing program.** Medicare's regulatory morass imposes enormous administrative costs on doctors, hospitals, and other medical professionals and undermines the quality of care for Medicare patients. While Congress should start creating a superior system for the next generation of retirees, it should take steps now to reduce the paperwork burden. A sound regulatory reform policy is embodied in the Medicare Regulatory and Contracting Reform Act of 2001 (H.R. 3391), sponsored by Representatives Nancy Johnson (R–CT) and Fortney Stark (D–CA).

Conclusion. Congress should start to reform Medicare this year. By taking the crucial first steps described above, it could begin to put the program on a sound financial footing and improve health care delivery for millions of seniors. Failing yet again to enact serious Medicare reform will only hasten the day of reckoning when taxpayers and seniors alike will face draconian options: massive tax increases or savage benefit cuts.

—Robert E. Moffit, Ph.D., is Director of Domestic Policy Studies at The Heritage Foundation.