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Why Medicare Premium Support Would Not Cost Future Beneficiaries $6,400 More

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Opponents of Medicare premium support routinely charge that it would cost future retirees $6,400 more annually. In fact, this dollar amount is incorrect, and the charge is erroneous. Such false charges are based on an outdated Congressional Budget Office (CBO) model of House Budget Committee chairman Paul Ryan's (R–WI) 2011 budget proposal.

Ryan's 2012 proposal, which was included in the 2013 House budget resolution, included a very different version of Medicare premium support. The policy changes in Ryan's second proposal and in his subsequent proposal with Senator Ron Wyden (D–OR) are substantial and significant. Curiously, these new changes also expose the methodological shortcomings of the CBO model. CBO director Douglas Elmendorf has publicly acknowledged that his agency does not have the methodological tools to accurately model Medicare premium-support plans and the impact of market competition.[1]

Estimates Based on Old Data and an Outdated Plan. It is inappropriate—indeed impossible—to use CBO's original 2011 evaluation of the Ryan premium-support proposal to estimate the economic impact of his later plans.

For example, the 2011 proposal did not include traditional fee-for-service (FFS) Medicare as a participant in the competitive premium-support system. Under CBO's analytical limitations, the absence of traditional Medicare as a competing plan would result in higher costs for the Medicare program. This was one of the main reasons that CBO concluded that the 2011 Ryan plan would cost the private sector 11 percent more to cover beneficiaries than traditional Medicare.[2] But in a 2006 analysis, CBO found that, through a process of competitive bidding, private plans could deliver Medicare benefits that would be significantly less expensive than traditional Medicare in high-cost areas.[3]

As with any analysis, the demographics are crucial. Over a quarter of all Medicare beneficiaries live in high-cost areas and could benefit from allowing competition between traditional FFS and private plans. Medicare data also show that private Medicare Advantage HMO plans are 5 percent less costly than traditional FFS.[4]

Since CBO views FFS as less expensive in low-cost areas affecting 15 percent of all beneficiaries, it assumes that a plan without traditional FFS premiums will result in a more costly program. CBO's static modeling also assumes that traditional Medicare will *always* be less expensive than private plans in these low-cost areas. Thus, CBO's current modeling rules mean that eliminating traditional Medicare would increase costs for many Medicare beneficiaries.

2012 Changes. In 2012, Ryan and the House Budget Committee made a major change in the House budget resolution that includes traditional FFS Medicare as a competing option in a future premium-support program. This change was also reflected in the Wyden–Ryan proposal, which shares many similarities with the 2012 proposal. Whereas the 2011 proposal increased some costs, the 2012 proposal would reduce costs to Medicare beneficiaries. With the retention of traditional Medicare, no Medicare beneficiary could be worse off with premium support.

This paper, in its entirety, can be found at **http://report.heritage.org/ib3745**

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Another change in the 2012 House budget proposal (and also reflected in the Ryan–Wyden proposal) is a more detailed competitive bidding structure for Medicare to determine the amount of the government contribution to private plans on beneficiaries' behalf. This structure is similar to the process today for plan payment in Medicare Part D.

Under a competitive bidding model, the contribution amount would vary based on bids by the competing companies, reflecting the real costs of providing health care in a competitive environment. FFS would be a bidder, which would establish a minimum benefit for beneficiaries. If FFS is the lowest bidder, then seniors would do no worse than the benefits and premiums under traditional Medicare. Moreover, under the 2012 House budget and Ryan–Wyden, a senior would be guaranteed at least two health plans whose premiums meet 100 percent of the contribution amount.

CBO Limitations. As noted, Elmendorf conceded that CBO simply does not have the tools to measure gains from competition among plans, which is the essence of Medicare premium support. CBO can easily score centralized price controls, but this means that market-based reforms will always be seen as less effective than price controls in generating "savings," even if the controls introduce or aggravate costly distortions of the market such as shortages or cost shifting.

CBO ignores the cost of price controls in limiting access, and these price controls are often ignored because they are so damaging to beneficiaries. If centralized price schemes were superior to competition, then the economic history of the 20th century would have been quite different. Countries that centralized industries would have enjoyed more prosperity than they did in reality.

In its recent scores, CBO does give much credit to savings from competition. Curiously, the current scoring process not only contradicts previous CBO analysis; it is also out of step with some of the most recent academic work. University of Minnesota economists have found that premium support with competitive bidding could save 9.5 percent annually.[5] A more recent study found that premium support could reduce Medicare spending by 9 percent annually.[6]

These savings to Medicare would be even higher with potential gains from overall competition and innovation. It is likely that an entrepreneurial company could learn to compete successfully with FFS even in current low-cost areas. Instead of FFS being the baseline bid, an innovative company could deliver services at a lower price and thus save even more money without affecting beneficiary care.

Flawed Analyses. The House budget resolution authored by Ryan in 2012 contains a Medicare premium-support proposal that is significantly different from the 2011 budget proposal. With Medicare FFS forced to compete on a level playing field with private plans under premium support, the overall cost of the Medicare program would decrease in comparison to the 2011 Ryan plan and in comparison to current-law Medicare. As academic research shows, these savings can be quite significant. Indeed, they can improve the value of Medicare benefits to beneficiaries.

Any claim, in the media or elsewhere, that uses the CBO evaluation of the 2011 Ryan plan is fundamentally flawed and erroneous. Furthermore, CBO's estimates are fundamentally flawed because the agency is unable to model market competition, the driver of virtually every other sector of the American economy. Medicare premium support would save money, and competition would ensure even greater savings for beneficiaries.

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