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Medicare Premium Support: The Best Reform Option

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The recent proposal by Representative Paul Ryan (R–WI) and Senator Ron Wyden (D–OR) showcases the growing, and bipartisan, agreement that premium support is the path forward for saving Medicare.¹ Premium support is a financing arrangement where the government makes a defined contribution to the health plan of an enrollee's choice. The government does this today for the vast majority of seniors enrolled in Medicare's drug program. Adopting premium support would guarantee beneficiaries access to a wide range of health plans and providers, while reducing costly bureaucracy and red tape and controlling costs. The Heritage Foundation has also outlined such an approach in *Saving The American Dream* and has already spelled out the details crucial to make such a reform work.²

Medicare premium support sharply contrasts with President Obama's approach, which relies almost exclusively on huge Medicare payment reductions to finance other entitlement expansions, creates a powerful Independent Payment Advisory Board (IPAB) to make further detailed and specific payment cuts, and imposes new layers of red tape on doctors and other medical professionals. Indeed, the Administration's Medicare payment reductions will drive Medicare payment levels down below Medicaid levels, thus guaranteeing seniors problems in accessing care.

Key Features of Reform. Virtually all major Medicare premium support proposals include certain key features. To make such a reform work,

Congress would have to take certain practical steps, such as:

- **Creating a market-based defined contribution.** Today, Medicare pays providers based on government formulas, which set the prices for thousands of medical services. Typically, these reimbursements are fixed artificially below true market prices. Converting to a premium support model, the government's contribution (the "premium assistance") to enrollee coverage would reflect the market price of competing plans. Participating health plans would submit an estimate based on the cost of offering a Medicare benefit package. In the Heritage proposal, the government payment (the "premium support") would be 88 percent of the average market price in any given geographical region for providing the benefit package consisting of Medicare Parts A, B, and D (or their actuarial equivalent) plus catastrophic coverage. Initially, the market price would be based on the weighted average of plan bids, which would include the bid from a reformed Medicare FFS plan. Later, it would be based on

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the weighted average of the three lowest plan bids. The government contribution would also be risk-adjusted for differences among Medicare beneficiaries.

- **Making traditional Medicare compete.** Today, roughly three out of four seniors are enrolled in traditional Medicare fee-for-service (FFS). FFS is a payment system to reimburse doctors, hospitals, and other providers for specific medical services and procedures. This outdated model lacks modern health insurance components, such as care coordination and disease management, as well as protection against catastrophic costs. Moreover, it is isolated from any real competition, a key factor in providing higher-quality care at a lower price. In a competitive market with a level playing field, the market share of insurance plans is purely a function of consumer choice. Under premium support, if traditional FFS is to continue, it must show that it can compete. In the Heritage proposal, Medicare FFS would be transformed into a unified plan offering the combined benefits of Part A, B, and D, plus a new catastrophic benefit.³ This plan would have a single premium and submit an annual estimate for providing Medicare benefits in competition with private health plans.
- **Enforcing a level playing field.** To ensure a level playing field for market competition and to enforce uniform rules, there must be an independent federal agency—entirely separate from the agency administering the new Medicare FFS option—in charge of overseeing the competitive system. Plans and patients alike should be protected from bureaucratic conflicts of interest. In the Heritage plan, Medicare’s Center for Drug and Health Plan Choice, the agency that today administers Medicare Parts C and D, would fulfill that role and would be independent of Medicare FFS.
- **Targeting taxpayer subsidies to need.** Currently, taxpayers usually finance between 85 and 90 percent of total annual Medicare costs. Under current law, taxpayer subsidies are already reduced for upper-income retirees, who, depending on their annual income, are required to pay up to 80 percent of the cost of their Medicare Part B and D benefits. In the Heritage plan, current income thresholds for taxpayer subsidies would be tightened, indexed to inflation, and the subsidy would be phased out entirely for the wealthiest cohort of retirees, about 3.5 percent of the Medicare population. The taxpayers’ subsidy would thus end for single retirees with an annual income in excess of \$110,000 and retired couples with an annual income in excess of \$165,000. The Heritage proposal maintains existing protections for low-income retirees.
- **Setting a budget backstop.** Intense market competition will control costs.⁴ Experience with premium support programs, such as the Federal Employees Health Benefits Plan and Medicare Part D, show significant savings, as do various econometric estimates of Medicare premium

1. Senator Ron Wyden (D–OR) and Representative Paul Ryan (R–WI), “Guaranteed Choices to Strengthen Medicare and Health Security for All: Bipartisan Options for the Future,” at <http://budget.house.gov/UploadedFiles/WydenRyan.pdf> (February 1, 2012). Ryan had an earlier premium support provision that was enacted in the House of Representatives as part of the budget. See House Budget Committee Fiscal Year 2012 Budget Resolution, “The Path to Prosperity: Restoring America’s Promise,” April 5, 2011, at <http://budget.house.gov/uploadedfiles/PathtoProsperityFY2012.pdf> (February 1, 2012).
2. See Stuart M. Butler, Alison Acosta Fraser, and William W. Beach, eds., *Saving the American Dream: The Heritage Plan to Fix the Debt, Cut Spending, and Restore Prosperity*, The Heritage Foundation, 2011, at <http://savingthedream.org/>. For the details of the Heritage premium support proposal, see Robert E. Moffit, “The Second Stage of Medicare Reform: Moving to a Premium Support Program,” Heritage Foundation *Backgrounder* No. 2626, November 28, 2011, at <http://www.heritage.org/research/reports/2011/11/the-second-stage-of-medicare-reform-moving-to-a-premium-support-program>.
3. Moffit, “The Second Stage of Medicare Reform: Moving to a Premium Support Program,” p. 5.
4. James C. Capretta, “The Case for Competition in Medicare,” Heritage Foundation *Backgrounder* No. 2605, September 12, 2011, at <http://www.heritage.org/research/reports/2011/09/the-case-for-competition-in-medicare>.

support proposals. As a fallback and for other budget process purposes,⁵ Congress should also put Medicare on a budget, just like other government programs, to restrain rather than fuel medical inflation. In the Heritage plan, Congress would cap annual Medicare spending at the rate of inflation measured by the Consumer Price Index (CPI) plus 1 percent, and adjust health plan payment accordingly. If spending exceeds the cap, the premium support contribution by the government would decrease by a proportionate amount to keep within the budget.

Premium Support Is the Best Option. As a direct result of the “Affordable Care Act,” Medicare “as we know it” has already ended. Medicare patients face reduced access to care, which will be increasingly rationed through relentless payment cuts. Key decisions will be made by an unelected board—the Independent Payment Advisory Board—which will determine specific payments Medicare providers

receive and under what circumstances. The Center for Medicare and Medicaid Innovation is tasked with shifting traditional Medicare from fee-for-service into new payment and delivery models that are to be imposed in top-down fashion. Meanwhile, the bureaucracy will metastasize, and doctors and hospitals will face more reams of costly rules and red tape.

Medicare premium support, long a bipartisan proposal, is the best alternative to this unhappy scenario. Premium support would guarantee better choices and broader access to quality care, faster innovation in care delivery, less waste and fraud in medical transactions, and superior cost control. For the next generation of taxpayers and retirees, there is no better option than premium support.

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5. Alison Acosta Fraser, “How to Fix the Federal Budget,” Heritage Foundation WebMemo No. 3174, March 1, 2011, at <http://www.heritage.org/research/reports/2011/03/how-to-fix-the-federal-budget>.