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Medicare Savings: 5 Steps to a Downpayment on Structural Reform

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If we solve our healthcare spending (Medicare), practically all of our fiscal problems go away. If we don't? Then almost anything else we do will not solve our fiscal problems.

—Dr. Victor Fuchs, Emeritus Professor of Economics, Stanford University, March 5, 2012. [1]

The Medicare savings embodied in President Obama's Fiscal Year 2014 budget proposal—mostly from provider payment reductions—are inadequate. Given the urgency of addressing the nation's deepening fiscal crisis, there is no reason why Congress and the Obama Administration cannot take more decisive steps toward comprehensive Medicare reform and larger savings. Variations on these proposals have attracted bipartisan support in the past.[2] Based on The Heritage Foundation's *Saving the American Dream* plan, the Center for Data Analysis (CDA) offers estimates of these potential savings:

1. **Reduce taxpayer subsidies for wealthy seniors, tighten income thresholds and index them to inflation, and phase out taxpayer subsidies for the wealthiest recipients entirely.**

With the exception of low-income seniors, federal taxpayers subsidize Medicare recipients regardless of their means. Congress should gradually reduce these Medicare subsidies beginning at an annual income of $55,000 for individual retirees—roughly $12,000 above the average annual income for an American worker—and $110,000 for couples. Subsidies would be phased out at 1.8 percent per year for every additional $1,000 in income above the threshold. At $110,000 annual income for single retirees and $165,000 for couples, taxpayer subsidies would be phased out entirely. Unsubsidized wealthy individuals and couples—about 3 percent of the Medicare population—could still enroll in Medicare and secure the pooling advantages of guaranteed-issue, community-rated health insurance, but would pay the full share of the premium.

In sharp contrast to the "cliff" effects of current law, in which retiree costs increase over just *four* income categories, the Heritage plan income thresholds are tighter, but they are also more gradual and less disruptive, and they would be indexed to inflation as measured by the Consumer Price Index (CPI). Seniors should note that under the Affordable Care Act, the existing income thresholds ($85,000 for an individual and $170,000 for a couple) are locked in place without *any* indexing until 2019.

10-Year Savings: $514 billion

2. **Raise the normal age of eligibility for Medicare and index the eligibility age to longevity.**

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The current age of eligibility for Medicare is 65. Given increasing life spans, and the opportunities to retain and tap into the talents of older workers, Congress should gradually raise the normal age of retirement from 65 to 68 over the next 10 years. Thereafter, the age of eligibility should be indexed to longevity. This change in retirement should coincide with changes in eligibility for Social Security as well.[3]

While securing savings from changes in the normal age of Medicare eligibility, Congress could also give older Americans who work beyond the normal retirement age tax breaks. For example, under the Heritage tax reform proposal, any person, regardless of income, who works beyond the normal retirement age would automatically qualify for an annual $10,000 tax deduction.[4]

10-Year Savings: $340.7 billion

3. Gradually raise the beneficiary's premium contribution to Medicare Part B and Part D premiums from 25 percent to 35 percent.

In 1966, the year Medicare started, beneficiaries were required to contribute 50 percent of the premium for Medicare Part B (physician services). Over time, this amount has shrunk to 25 percent, leaving taxpayers with the remaining 75 percent. An increase to 35 percent would refine the balance between the beneficiary and the taxpayer. In making this transition, Congress should, however, retain certain features of current law, such as the income-based premium structure and the existing "hold harmless" provisions, to protect low-income seniors.[5]

Ideally, such an increase in beneficiary contributions should be phased in over five or 10 years.[6] For modeling purposes, a 10-year phase-in of the premium increases is assumed at the rate of 1 percent per year.

10-Year Savings: $273.1 billion

4. Eliminate Medicare Part A deficits with a temporary premium.

Medicare Part A (the hospitalization insurance trust fund) is projected to be insolvent in 2024. While many seniors strongly believe that the federal payroll taxes they paid during their working lives has "paid" for their hospitalization benefits, this belief is largely erroneous. Most did not pay nearly enough to cover their actual costs, getting two or three times more in Medicare benefits than they paid in Medicare taxes.[7] Instead of continuing annual trust fund cash deficits, increasing the payroll tax, or another raid on the debt-ridden Treasury, adding a temporary premium is compatible with the social insurance principle that Medicare beneficiaries should pay for their benefits.

Under the Heritage proposal, the annual supplemental premium would be flexible,

1. Cited by Gina Kolata, "Knotty Challenges in Health Care Costs," *The New York Times,* March 5, 2012, http://www.nytimes.com/2012/03/06/health/policy/an-interview-with-victor-fuchs-on-health-care-costs.html?_r=0 (accessed April 11, 2013).
2. These recommendations are also addressed in detail by Robert E. Moffit, "The First Stage of Medicare Reform: Fixing The Current Program," Heritage Foundation *Backgrounder* No. 2611, October 17, 2011, http://report.heritage.org/bg2611.
3. Under the Heritage proposal, the eligibility age for the *early* retirement option for Social Security would be raised from 62 to 65. Stuart M. Butler et al., *Saving the American Dream: The Heritage Foundation Plan to Fix the Debt, Cut Spending, and Restore Prosperity* (Washington, DC: 2011), p. 14, http://www.savingthedream.org/.
4. Ibid.
5. Under current law, Medicare enrollees are protected from Part B premium increases if the dollar amount of those increases exceeds the dollar amount of their Social Security Cost-of-Living Adjustments (COLA). The practical result is that most seniors have not seen an increase in their standard Part B premiums in recent years.
6. Congress could raise the beneficiary share by 2 percent per year over five years, as recommended by the CBO. That five-year transition period would enable the Administration and the public to prepare for a defined-contribution ("premium support") Medicare program. Alternatively, Congress could increase the premiums by 1 percent per year over 10 years. In either case, the savings would be substantial.
7. For example, a retiring woman earning an average wage ($43,500 in 2011 dollars) will have paid $60,000 over her lifetime in Medicare taxes and will receive $188,000 in lifetime Medicare benefits. See C. Eugene Steuerle and Stephanie Rennane, "Social Security and Medicare Taxes and Benefits over a Lifetime," Urban Institute, updated June 2011, p. 2, http://www.urban.org/UploadedPDF/social-security-medicare-benefits-over-lifetime.pdf (accessed April 11, 2013).

rising or falling to cover the projected annual hospital insurance deficits. It would also be modest (roughly $30 per month), and could be reduced even more for the bulk of seniors if the additional premium was "means-tested."

10-year Savings: $168.5 billion

5. **Combine Medicare Part A and Part B, streamline cost sharing, and add a catastrophic limit.**

   Traditional Medicare needs to move away from its multi-part structure to a streamlined modern insurance program. Today, seniors in traditional Medicare receive benefits in Part A (hospitalization) and Part B (physician services). But more than nine out of 10 enroll in supplemental (mostly private) coverage to fill in Medicare's coverage gaps. Consolidating Medicare Parts A and B into a single trust fund, with uniform deductibles and cost sharing, and setting a catastrophic limit would lay the structural groundwork for traditional Medicare as a plan to compete in a new defined-contribution program. Such intense competition would ensure ample savings for seniors and taxpayers alike.

   By altering the structure of traditional Medicare, the perverse economic incentives that drive excessive Medicare spending would diminish, seniors would gain from slower premium growth, and savings would be secured for the taxpayers.

   For modeling purposes, Heritage has recommended a proposal offered by the Congressional Budget Office (CBO): a single Medicare out-of-pocket cap of $5,500 for Parts A and B, plus a single deductible and uniform co-insurance, plus an exemption of the first $550 of Medicare patient cost sharing from coverage by supplemental insurance.

   10-year Savings: $93 billion

No Time for Delay. Congress and this Administration cannot cope effectively with the country's fiscal crisis unless it addresses the inevitable challenge of Medicare. Adopting a variety of options, as described above, is a critical first step that can achieve serious savings and secure a down payment for longer term structural reforms.[8]

The alternative is to delay or do nothing consequential. Inconsequential actions in the near term guarantee even more undesirable consequences in the long term. The longer the delay, the more difficult the road ahead.

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8. Of course, the best long-term option for Medicare is to create a defined-contribution (premium support) system of financing that would intensify competition and control costs. For a detailed discussion of this broader reform, see Robert E. Moffit, "The Second Stage of Medicare Reform: Moving to a Premium Support Program," Heritage Foundation *Backgrounder* No. 2626, November 28, 2011, http://report.heritage.org/bg2626.