



Saving the American Dream: Comparing Medicare Reform Plans

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Executive Summary

The United States is at a fiscal tipping point—mostly due to the explosive growth in federal entitlement spending, especially on Medicare. The long-term unfunded liability of the Medicare program—promised benefits that are not financed—is almost \$37 trillion, and it is relentlessly generating annual deficits. Medicare’s hospital insurance (HI) trust fund faces a shortfall of \$31.8 billion in 2012. The Congressional Budget Office (CBO) estimates that Medicare spending will jump from \$560 billion in 2012 to \$1.041 trillion in 2022. Each year of delay makes reform that much harder.

To preserve Medicare for the next generation of retirees, The Heritage Foundation has developed a Medicare premium support plan as part of its comprehensive budget reform, *Saving the American Dream*. With premium support, the government makes a fixed payment (a defined contribution) to a health plan chosen by an enrollee. If an enrollee wants to purchase a plan that is more expensive than the government payment, the enrollee may do so, paying the additional cost. If an enrollee wants to buy a less expensive plan, the enrollee may also do so, and keep the savings.

Health plans would compete directly with each other for market share. Their ability to retain or expand their enrollment would depend solely on their ability to provide the best package of benefits and the highest quality of care at the most competitive price. The American Enterprise Institute, the Cato Institute, the National Center for Policy Analysis, and the Progressive Policy Institute have all endorsed this general approach to comprehensive Medicare reform.

A Powerful Consensus. Representative Paul Ryan (R–WI), chairman of the House Budget Committee, has been a leading champion of premium support. The House Budget Resolution is the most recent version of his Medicare proposal. Representative Ryan also joined Senator Ron Wyden (D–OR) in offering an updated premium support proposal. Likewise, Senators Richard Burr (R–NC) and Tom Coburn (R–OK) have offered a robust

premium support plan, as have Dr. Alice Rivlin, former Director of the Congressional Budget Office, and former Senator Pete Domenici (R–NM). Senator Joseph Lieberman (I–CT), along with Senator Coburn, has also proposed a major reform of the current Medicare fee-for-service (FFS) program.

The leading Medicare premium support proposals, including The Heritage Foundation’s, have certain features in common:

- **A requirement that traditional Medicare compete with private plans.** Under the Heritage plan, Congress would transform the complex Medicare FFS program into a health plan with the capacity to compete with private plans chosen by enrollees. All other leading proposals would do the same.
- **Market-based bids to determine government payment for health plans.** With the Heritage proposal, the government’s contribution to a Medicare enrollee’s coverage would be based on an annual process of (regional and national) competitive bidding among health plans to provide at least the traditional Medicare benefits. Seniors choosing plans below the government contribution would receive a rebate and seniors choosing above the government contribution would pay the difference. All other leading proposals are based on similar financing.
- **An adjustment of beneficiary payment or taxpayer subsidies for income.** Taxpayers today directly finance between 85 percent and 90 percent of total annual Medicare costs. Under the Heritage proposal, current income thresholds for taxpayer subsidies would be tightened, and phased out entirely for the wealthiest cohort of retirees. All other leading proposals retain or expand the application of income-based subsidies for Medicare benefits.
- **An authorization of an agency to oversee the competitive program and guarantee strong consumer protections.** A federal agency should enforce uniform rules for health insurance and rules for consumer protection, such as marketing rules and fiscal solvency requirements, and administer a risk-adjustment program. In the Heritage plan, the existing Center for Drug and Health Plan Choice would fulfill that role, but would be independent of the Centers for Medicare and Medicaid Services (CMS), which runs traditional Medicare. All other leading proposals put in place a mechanism to enforce rules for market competition and guarantee strong consumer protection.
- **A provision for, or improvement of, risk adjustment for health plans.** With patient choice among a wide array of competing plans, the affordability and continuity of coverage can be disrupted by adverse selection (the concentration of older and sicker beneficiaries in certain plans) thus pushing up costs and driving out plans. To cope with adverse selection and stabilize the market, the Heritage plan improves upon the risk-adjustment mechanisms of current law. All other leading proposals adopt risk-adjustment systems for insurance.

New Incentives. Premium support would be transformational. New and powerful economic incentives unleashed by the free-market forces of patient choice and health

plan competition would not only improve quality, but also control costs and reverse Medicare's current rush toward disastrous debt.

No major proposal has yet been committed to legislative language, and each differs in degree and level of detail. Heritage, for instance, would put Medicare on an annual budget, but not all proposals do so. Heritage would also build a clear wall of separation between CMS and the administration of the new competitive system, but not all proposals do so.

While all proposals provide protection from catastrophic illness, they differ on cost sharing and subsidy levels based on income. Differences in detail are important, but they are of secondary importance to the economic impact of expanded premium support payment for Medicare benefits. This is a fundamental structural change in total Medicare financing.

Abstract: *Medicare is central to the debate on federal entitlement spending. A failure to reform Medicare, and thus control entitlement spending, will rob Americans of a fleeting opportunity to escape ruinous debt, crushing taxation, or severe austerity measures. Medicare's long-term unfunded liability is almost \$37 trillion, and it is relentlessly generating annual deficits. Medicare's hospital insurance trust fund faces a shortfall of \$31.8 billion in 2012. The Congressional Budget Office estimates that Medicare spending will jump from \$560 billion in 2012 to \$1.041 trillion in 2022. Each year of delay makes reform that much harder. This Heritage Foundation Backgrounder compares the Heritage reform plan, advanced in Saving the American Dream, with five other reform plans. They differ in detail, but their main features are similar. Congress should build on this powerful consensus and craft a comprehensive reform of the Medicare program.*

The United States is at a fiscal tipping point—mostly due to the explosive growth in federal entitlement spending, especially on Medicare. The Congressional Budget Office (CBO) estimates that Medicare spending will jump from \$560 billion in 2012 to \$1.041 trillion in 2022.[\[1\]](#)

A Powerful Consensus. The good news is that some Members of Congress are forging a powerful consensus on reforming Medicare. Senators Richard Burr (R–NC) and Tom Coburn (R–OK), and Representative Paul Ryan (R–WI), chairman of the House Budget Committee, and Senator Ron Wyden (D–OR) would improve upon the experience of defined-contribution (“premium support”) financing that today characterizes the competitive private plan program in Medicare Part C and the Medicare drug program in Medicare Part D. In other words, the expansion of a system of financing that already provides benefits for the vast majority of retirees would be the least disruptive of all changes, particularly the deep Medicare payment cuts mandated by current law.[\[2\]](#) By harnessing free-market forces of choice and competition, already serving the vast majority of Medicare beneficiaries, these Members of Congress would create a better Medicare program for future retirees. Meanwhile, Senator Joseph Lieberman (I–CT) and Senator Tom Coburn would fix certain broken features of the existing Medicare program

that drive perverse economic incentives, which, in turn, contribute to escalating costs and compromise the quality of care.

The Heart of Reform. Premium support is at the heart of major Medicare reform proposals. It is a system of defined-contribution financing, where the government makes a direct and fixed payment to a health plan chosen by an enrollee. If an enrollee wants to purchase a plan that costs more than the government payment covers, the enrollee may do so, paying the additional cost. If an enrollee wants to buy a less expensive plan, the enrollee can do that as well, and keep the savings. Beneficiaries would choose health plans within an intense competitive environment, where plans would compete directly with each other for market share. Their success would depend on their ability to provide the best package of benefits and the highest quality of care at the most competitive price.

Beyond a growing band of congressional leaders, premium support is backed by such public policy organizations as the American Enterprise Institute, Bipartisan Policy Center, the CATO Institute, National Center for Policy Analysis, and the Progressive Policy Institute.[\[3\]](#)