



Joint Economic Committee

CHAIRMAN ROBERT F. BENNETT

ECONOMIC POLICY RESEARCH

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PRESCRIPTION DRUGS ARE ONLY ONE REASON WHY MEDICARE NEEDS REFORM

As Congress considers new Medicare legislation, much of the debate focuses on the need to extend prescription drug coverage to Medicare beneficiaries. That need is certainly pressing and important, but it is not the only reason that Medicare needs reform. Reforms are also needed to:

- *Improve the long-term financial viability of the program.* The impending retirement of the “Baby Boom” generation will dramatically increase the fiscal burden of providing Medicare benefits. Over the next few decades, Medicare costs will double relative to the size of the economy – from 2 percent of GDP today to 4 percent in 2025 – and then double again – to 8 percent of GDP in 2075. This growth will accelerate substantially when Congress adds a prescription drug benefit.
- *Make Medicare more responsive to health care advances.* Medicare’s current structure does not have the flexibility to quickly adapt to rapid advances in modern health care. Medicare lags far behind other insurers in providing prescription drug coverage, disease management programs, and a host of other advances. Reforming Medicare to create a more self-adjusting, innovative structure could improve both the efficiency and quality of the medical care provided.
- *Give beneficiaries greater choice and introduce greater competition between plans.* Giving Medicare beneficiaries greater choice has at least two key advantages: It allows the beneficiaries to be the primary customer, rather than the government or a former employer, while it also creates powerful incentives for all Medicare plans, public or private, to provide the highest quality health at the most competitive price.

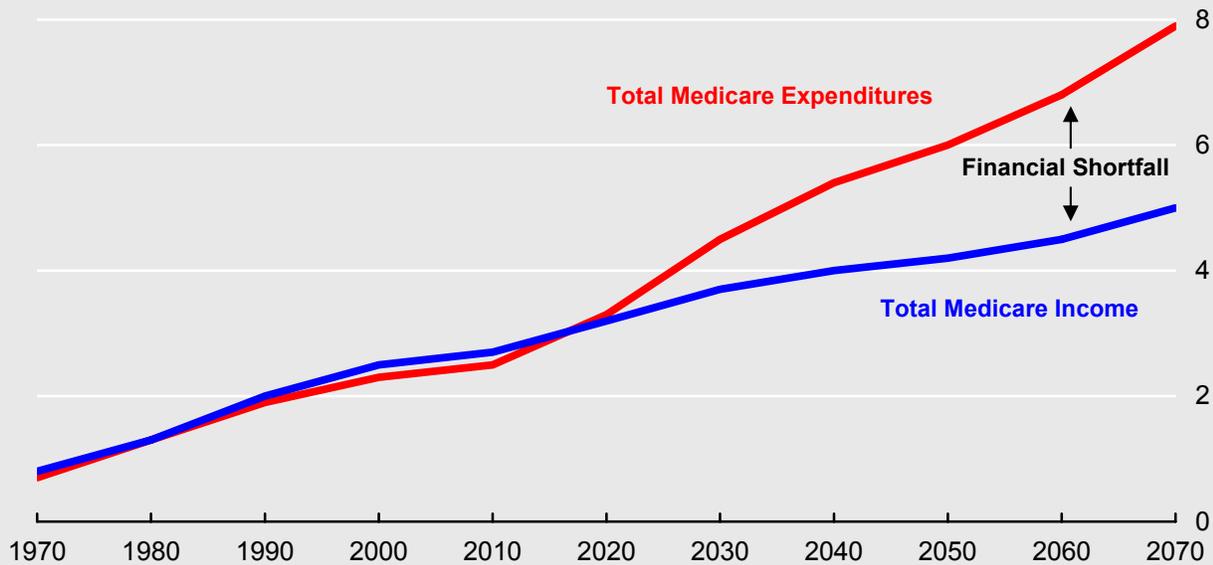
These reforms all require that Medicare become more efficient, more flexible, and more responsive – in other words, more market-oriented. Adding a prescription drug benefit isn’t enough.

IMPROVING MEDICARE’S LONG-TERM FINANCIAL VIABILITY

Adding a prescription drug benefit will significantly improve the Medicare benefit package; however, it will also add substantial costs to an already financially vulnerable system. Medicare reform should therefore focus on making the program as efficient as possible with the funds available, or risk a crushing financial burden on the next generation of taxpayers and beneficiaries.

Introducing choice and competition will do much to improve the efficiency of the Medicare program. Beneficiaries with the power to choose among competing plans become the primary consumer that both public and private health plans must attract. Beneficiaries acting as prudent consumers of their own health care indirectly help the taxpayers as well. As beneficiaries choose among competing plans for the highest quality at the best price, they slow the growth in the program for both themselves and the taxpayers.

Chart 1. Medicare Expenditures and Income
(As a percentage of GDP)

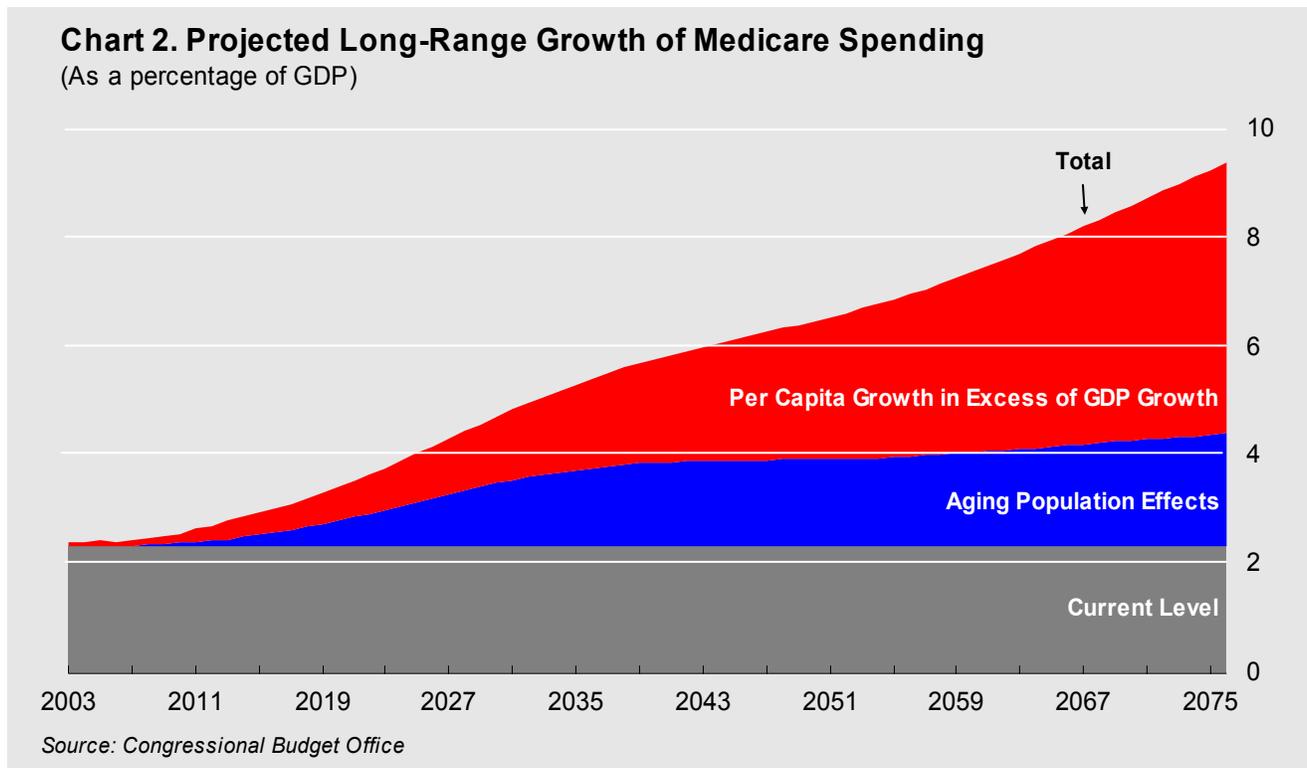


Source: 2003 Medicare Trustees Report, pg. 25

The need for such reform is clearly evident in the latest forecasts from the Medicare Trustees.¹ The Trustees forecast that Medicare spending will increase dramatically as the “Baby Boom” generation retires, and that this spending will rapidly outstrip the revenues traditionally used to pay for it. Chart 1 illustrates these financial challenges by relating Medicare’s spending and income sources to the overall size of the economy, as measured by the gross domestic product (GDP). This is the most meaningful way to measure Medicare’s fiscal burdens because it compares Medicare spending to the economy’s overall capacity to pay for that spending.

According to the Trustees’ forecasts, Medicare spending will double, relative to the size of the economy, over the next 20 to 25 years – and then double again by 2075. These forecasts are based on Medicare’s current benefits package, so this cost growth will accelerate further when Congress enacts a prescription drug benefit. Even under the current benefit package, funding sources will not come close to covering Medicare’s costs in future years.

Chart 2 illustrates how this upward pressure on Medicare spending is split between demographics and other factors. Demographics certainly compound Medicare’s financial problems, but it is clear that the majority of Medicare’s future financial woes will be driven by explosive health care spending, not demographics. Making Medicare a more efficient, prudent consumer of health care will not close this entire gap, but improved efficiency slows the growth rate resulting in a smaller financial burden for future generations of beneficiaries and taxpayers.



MAKE MEDICARE MORE RESPONSIVE TO HEALTH CARE ADVANCES

Medicare reform also holds the promise of a more innovative, self-adjusting Medicare program for the future. The current Medicare structure results in an inflexible, non-responsive way of delivering medical care. The simple fact that it has taken three decades to add a prescription drug benefit clearly demonstrates the limits of this structure. New technologies and treatments will continue to be developed; Medicare should be restructured so it incorporates them rapidly, not after another 30 years.

Congress has often countered Medicare’s non-responsive bureaucracy by legislating even the smallest of changes. While responsive to the variety of interests that seek congressional redress, these changes are not always driven by the best science available or in the best interest of the long-run financial and actuarial soundness of the Medicare program. Not surprisingly, it has been simply impossible for Members and staff to craft Medicare directives that keep the program current with the myriad of opportunities and challenges that arise on the front lines of medicine every day.

Fortunately, Congress may draw on decades of experience with more responsive, market-based government health insurance programs that Congress can draw from. For example, the federal employees and retirees program, FEHBP, and the California civil servants and retirees program, CalPERS, have shown that the government and the private market working together can deliver greater responsiveness, innovation, and flexibility, yet deliver cost growth that is comparable to Medicare’s.²

GIVE BENEFICIARIES THE CHOICE OF MORE COMPREHENSIVE HEALTH COVERAGE

A reformed Medicare program including drug coverage has the potential to offer more comprehensive coverage and improve some of the most significant deficiencies of the current program. Medicare has the least generous benefits package among leading forms of insurance. A recent study by the Congressional Research Service (CRS) found that Medicare benefits have not significantly expanded

over the years, while other insurers have significantly expanded what they cover.³ CRS found that between 1977 and 1999, Medicare increased the percentage of total health care expenses it covered from 53.2 percent to 56.0 percent, not a statistically significant increase. They also found that for the same time period, the percentage of health care expenses paid by private insurers grew from 50.7 percent to 70.0 percent, a statistically significant increase.

A reformed Medicare program where the beneficiaries are the primary customers opens a range of possibilities for innovative benefit design, including catastrophic coverage, reduced cost-sharing, disease-management programs and other innovations that can be incorporated into the plan's benefit package without an act of Congress.

CONCLUSION

Medicare reform needs to be about more than adding a prescription drug benefit. Looking ahead, Medicare will face enormous fiscal challenges as the "Baby Boom" generation retires and as the program expands to cover prescription drugs. Looking back, Medicare has a disturbing record of being slow to embrace health care advances and failing to realize the cost and quality benefits that come from customer choice and competition. The challenges that lay ahead will require flexibility and innovation to protect Medicare for future generations.

RECENT JEC PUBLICATIONS ABOUT MEDICARE

- "Prescription Drugs Are Only One Reason Why Medicare Needs Reform," June 17, 2003. Explains why the program needs market-based reforms to become more financially viable and responsive to patients.
- "Health Insurance Spending Growth – How Does Medicare Compare?" June 10, 2003. Compares cost growth rates of Medicare with various insurers, such as the Federal Employee Health Benefits Program (FEHBP).
- "Medicare Beneficiaries' Links to Drug Coverage," April 10, 2003. Reveals which Medicare beneficiaries typically have coverage of prescription drugs now and how they get it.

Copies of these publications can be found online at the committee's website at jec.senate.gov

¹ 2003 Medicare Trustees Report, pg. 25.

² Joint Economic Committee, "Health Insurance Spending Growth – How Does Medicare Compare?," June 10, 2003.

³ "Follow-Up Memorandum To The Distribution Of Total Expenses By Source Of Payments For Two Groups." Technical memorandum to the Joint Economic Committee, 5/22/03.