Medicare Coverage and Financing

Issue

The Medicare program is a valuable source of health insurance coverage for more than 41 million Americans. Medicare enjoys broad public support, but the program faces a number of challenges in the years ahead, including the implementation of the new Medicare drug benefit beginning in 2006. Another issue pertains to the affordability of health and long-term care as premiums and health care costs rise faster than income. Lastly, there is the question of how to finance Medicare benefits for a population expected to double in the next 25 years, without unduly burdening beneficiaries, taxpayers, and the overall economy.

Background

The Medicare program provides health coverage to over 41 million Americans including virtually everyone age 65 and older and over 6 million younger adults with permanent disabilities. Like Social Security, Medicare is a "social insurance" program that provides health coverage, regardless of income or health status. People pay into Medicare throughout their working lives, and are generally eligible for Medicare when they turn 65. Medicare covers most health care services, but does not currently pay for prescription drugs or long-term care services, and has relatively high cost-sharing requirements. Beginning in 2006, Medicare will begin to provide some prescription drug coverage as a result of the recently passed Medicare Modernization Act.

Medicare serves a diverse population. While some have high incomes and fairly good health, many on Medicare live with multiple chronic conditions and live on fixed incomes. Nearly one-third say their health status is fair or poor, about a quarter have problems with mental functioning or cognitive impairments, and more than 2 million Medicare beneficiaries live in nursing homes or other long-term care settings. Most rely on Social Security for the bulk of their income, and are especially vulnerable to the high and rising cost of health care services. Nearly four in ten have incomes below 150 percent of poverty – about $14,000 for individuals and $18,700 for couples.

Today, Medicare enjoys broad support among seniors and the general public, but the program faces a number of challenges for the future.

- Implementing the Medicare drug benefit in 2006, and addressing concerns about the adequacy of the drug benefit
- Making health and long-term care affordable over time, particularly as premiums and other health care costs rise more rapidly than income.
- Financing Medicare benefits for future generations, without unduly burdening beneficiaries, taxpayers, and the overall economy.

Finally, a key question that could drive much of the future debate about Medicare relates to the role of government versus private plans under Medicare.

Policy Challenges Facing Medicare

Implementing the Medicare Drug Law

After years of discussion and debate, Congress passed the Medicare Modernization Act of 2003 which included a new outpatient prescription drug benefit. Beginning in 2006, beneficiaries will be able to get prescription drug coverage, either by signing up with new private insurance plans set up to offer the Medicare drug benefit for those who prefer the traditional fee-for-service program, or by enrolling in integrated health plans, such as HMOs or PPOs.

Under the standard drug benefit, beneficiaries in 2006 will:

- Pay the first $250 in drug costs (deductible);
- Pay 25% of total drug costs between $250 and $2,250;
- Pay 100% of drug costs between $2,250 and $5,100 in total drug costs (the $2,850 gap or "hole in the doughnut"), equivalent to $3,600 in out-of-pocket spending for covered drugs;
- Pay the greater of $2 for generics, $5 for brand drugs, or 5% coinsurance after reaching the $3,600 out-of-pocket limit or catastrophic threshold.

Beneficiaries will also pay an *estimated* $35 per month in premiums for basic drug coverage in 2006, in addition to the Part B premium. These cost-sharing requirements will not apply to those with low incomes and limited assets (generally incomes less than about $14,000/year), who will receive more generous subsidies to help pay for their medications.

A critical issue for seniors relates to the adequacy of the drug benefit and whether it will do enough to lower their drug costs. The benefit gap or "hole in the doughnut" is certainly a major concern for those with multiple health conditions, taking numerous prescription drugs as part of their treatment.

The new Medicare law relies on market-based competition to drive down drug costs and explicitly prohibits the federal government from negotiating prices directly with manufacturers, pharmacies, or plans. Skeptics – generally Democrats – question the ability of private plans to control costs through competition, and instead favor changing the law to allow the federal government to use its buying power to negotiate with drug companies to try to get lower prices for prescription drugs for people on Medicare. Proponents of competition – generally Republicans – argue that substantial savings will be obtained by private plans and are concerned that government negotiations will result in price controls that would ultimately drive US drug companies to do less research and development.

Keeping Medicare Benefits Affordable

Despite significant protections offered by Medicare, there are gaps in Medicare's benefits package that pose financial concerns for many people on Medicare. Unlike many private plans, Medicare does not have a cap on out-of-pocket spending, exposing those with serious medical problems to extremely high expenses. Today, seniors spend roughly 22 percent of their income on health care. Medicare does not cover long-term care or pay for eyeglasses or hearing aids. In 2005, Medicare beneficiaries will be able to use discount cards for drugs, but the real drug benefit does not begin until 2006.

To help fill in these gaps and make care more affordable, most people on Medicare have some form of supplemental coverage, such as an employer or union plan, a Medigap policy, or Medicaid for those with very low incomes. There are concerns, however, that rising health care costs will lead to the erosion of such benefits in the future. Employers have begun to ratchet back retiree health benefits in recent years and some predict that employers may now discontinue drug coverage despite financial incentives in the Medicare drug law for employers to continue as a primary source of drug benefits.

In the current environment, there is little discussion about expanding Medicare to cover long-term care or in substantially reducing cost-sharing for people covered by the program. Some support expanding the role of private managed care plans as a means to improve benefits and lower costs under Medicare. Others question this approach given the recent withdrawal of Medicare HMOs throughout the country, cut backs on benefits, and increases in premiums and cost-sharing paid by enrollees.

The challenge is that strategies to protect beneficiaries from higher costs could add costs to the program, requiring additional revenues to help pay for them. Policymakers may not be inclined to add additional costs to Medicare given the cost of the new drug benefit, particularly during this period of historically high federal deficits. In fact, some experts expect that lawmakers may look to Medicare for cost-saving measures in an effort to help control the growth of Medicare spending and lower the federal deficit. In a limited way, Congress took a step in that direction by charging higher premiums for Medicare beneficiaries with incomes over $80,000/single ($160,000/couple) and by raising the part B deductible.

Financing Care for Future Generations

One of the greatest challenges facing Medicare is financing care for the rapidly growing Medicare population. Financing for Medicare generally comes from three main sources: payroll taxes paid by workers and employers; part B premiums paid by beneficiaries ($66.60/month in 2004 rising to $78.10/month in 2005) and general revenues. Program rolls are projected to swell from 41 million today to 76 million by the year 2030 and there will be fewer workers per retiree to help support those on Medicare. Government experts warn that by 2019, there will be insufficient funds in the Medicare Hospital Trust Fund to pay for benefits.

How to make Medicare financially solvent over the long term, while meeting the health care needs of an aging population is a critical policy concern. While long-term reforms are not the focus of either presidential candidate's health policy agenda, there are a number of broad strategies under discussion.

The most far-reaching proposal would fundamentally restructure the Medicare program along the lines of the Federal Employees Health Benefit program (FEHBP). This approach would essentially transform Medicare from a program that provides a defined set of benefits to a "defined contribution system." Under this approach, beneficiaries would get a choice of health plans and Medicare would pay a fixed dollar amount or share of the cost of the care provided by the health plan. If Medicare payments do not cover the full cost of the monthly premium amount, beneficiaries would have to pay the difference out of their own pockets.

Proponents – generally Republicans – say that competition between private plans could ultimately control Medicare spending and offer beneficiaries a choice of health plans with more generous benefits and lower costs. Medicare expenditures would be more predictable and controllable with a defined government contribution to plans.

Skeptics of this approach – generally Democrats – argue that Medicare's historic guarantee of a defined package of benefits should be preserved in a modernized fee-for-service (FFS) program administered by the government. They raise concerns that private health plans may not have a long-term commitment to the FFS Medicare program and that moving to fixed payments for covered care may lead to increased out-of-pocket expenses for beneficiaries.

Other Medicare proposals would keep the program's basic framework in place. These include: cutting the growth in Medicare payments to doctors, hospitals, and health plans, increasing beneficiary premiums and cost-sharing, or raising the age of Medicare eligibility. None of these changes are without controversy. Another approach to help pay for future generations – but one that is not currently on the table – would be to increase revenues, such as the payroll tax.

Assessing Candidate Positions

Neither of the presidential campaigns or major political parties has released a detailed set of Medicare policy proposals. Much of the debate thus far has focused on disagreements about the new prescription drug benefit and the role of private insurance plans in Medicare. Less attention has been paid to broader reforms. However, the direction and pace of reform will be significantly affected by the election outcome. The broad visions of how Medicare should be designed in the future will certainly inform the policy choices made by Congress and the administration over the next four years. The future direction of the program appears to be governed by differences in ideology, particularly the role of government versus the role of the private sector. It is important to carefully consider the policy recommendations of the candidates to understand their vision for the future of Medicare.

The following questions are intended to help discern the candidates' likely approach to Medicare reform.

- What strategies would you recommend to improve the Medicare drug benefit?
- Should the government play a direct role in negotiating drug prices, or should this be left to market competition among private health plans?
- How would you propose to help families with the high cost of long-term care?
- What is the appropriate role for private health plans in Medicare?

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