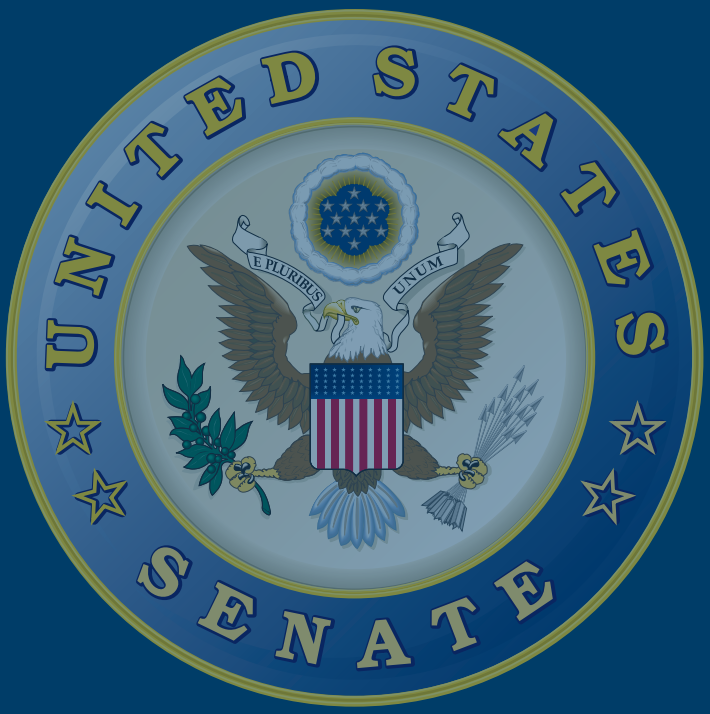
Strengthening Medicare: A Primer on Competitive Bidding



An Analysis by the Senate Finance Committee Minority Staff
U.S. Senator Orrin Hatch, (R-Utah), Ranking Member

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EXECUTIVE SUMMARY

Hard-working Americans pay Medicare payroll taxes throughout their working lives, with the expectation that Medicare will be there for them when they retire. But Medicare is in grave fiscal trouble — far greater trouble than most Americans realize. Congressional Budget Office (CBO) Director Doug Elmendorf has said that spending on health care entitlements, most notably Medicare, represents our "fundamental fiscal challenge."[1] According to the 2012 Medicare Trustees Report, "[g]rowth of this magnitude, if realized, would substantially increase the strain on the nation's workers, the economy, Medicare beneficiaries, and the federal budget."[2]

If Medicare is to be saved, it must be reformed. There has been much discussion of reform that would include a competitive system of bidding on guaranteed Medicare benefits among traditional fee-for-service and carefully-regulated private plans. This market-oriented approach has a long and bipartisan history that lawmakers and the Executive Branch should consider when they explore options to ensure Medicare's solvency.

Over the years, variations of a competitive bidding concept have been proposed by respected and thoughtful policy innovators from across the ideological spectrum. Proposals for a competitive bidding reform of Medicare date to the 1970s, and in 1999, the bipartisan Medicare Commission made recommendations stating, "[w]e believe a premium support system is necessary to enable Medicare beneficiaries to obtain secure, dependable, comprehensive high quality health care coverage," and "modeling a system on the one Members of Congress use… is appropriate…"[3] Just months after the Commission's report, President Bill Clinton proposed a major set of Medicare reforms with his own version of premium support, which he called a "*competitive defined benefit proposal*."[4] Even key health advisors to President Obama believe that competitive bidding proposals show promise.[5]

The strong bipartisan support for Medicare competitive bidding is not surprising considering the empirical evidence showing that it would achieve cost reduction without harming Medicare beneficiaries. The Bipartisan Policy Center estimated that a proposal put forward by Congressman Paul Ryan and former OMB Director Alice Rivlin would save $175 billion over the 2016-2022 budget window.[6] A comprehensive evaluation of another bipartisan competitive bidding proposal published by the American Enterprise

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[1] Congressional Budget Office Director Doug Elmendorf: *Fundamental Fiscal Challenge: Rising Health Care Costs*. February 1, 2012. Available online at: http://www.cbo.gov/publication/42914.

[2] Medicare Trustees: *2012 Annual Report*. April 23, 2012. Available online at: http://www.cms.gov/Research-Statistics-Data-and-Systems/Statistics-Trends-and-Reports/ReportsTrustFunds/Downloads/TR2012.pdf.

[3] National Bipartisan Commission on the Future of Medicare: *Building a Better Medicare for Today and Tomorrow*. March 16, 1999. Available online at: http://rs9.loc.gov/medicare/bbmtt31599.html.

[4] National Economic Council/Domestic Policy Council: The President's Plan to Modernize and Strengthen Medicare for the 21st Century. July 2, 1999. Available online at: http://clinton4.nara.gov/WH/New/html/Medicare/index.html.

[5] National Journal: *Mixed Messages from Obama Advisors on Medicare*. September 10, 2012. Available online at: http://www.nationaljournal.com/healthcare/mixed-obama-message-on-medicare--20120910.

[6] Bipartisan Policy Center: *Domenici-Rivlin Protect Medicare Act*. November 2011. Available online at: http://bipartisanpolicy.org/sites/default/files/D-R%20Protect%20Medicare%20Act.pdf.

Institute (AEI) found that these reforms could save $339 billion over ten years without disrupting seniors' premiums.[7]

The Moral Case for Medicare Reform

Americans pay Medicare payroll taxes throughout their working lives with the expectation that Medicare will be there for them when they retire. Today, the Medicare program provides vital health care services for approximately 50 million Americans, and by 2022 the program is expected to cover 66 million beneficiaries.[8]

Unfortunately, the Medicare program is in grave fiscal crisis. The program's costs are growing exponentially faster than its ability to pay for them. Medicare has accumulated a $37 trillion unfunded liability, and unfortunately, the current Administration has declined to put forward proposals to address this underfunding and to deal with Washington's $16 trillion additional debt. The failure to address this fiscal reality jeopardizes the health security of millions of our seniors and the nation's longer term fiscal position. Our elected leaders have a moral obligation to ensure the promises made to today's seniors and the next generation of taxpayers are honored. Americans have paid into Medicare for decades, and they deserve to know that the program that they have paid into will be there for them when they retire.

The Truth about "Medicare as We Know It"

Medicare's mission — to protect its beneficiaries from losing their life savings because of costly health problems — is at risk. While 50 million beneficiaries rely on the program, Medicare's troubled financing structure jeopardizes its ability to pay for the care of those patients. As outlined below, no American business could survive with a balance sheet like that of the Medicare program.

CBO Director Doug Elmendorf has noted that spending on health care entitlements represents our "fundamental fiscal challenge" and recently emphasized that "the aging of the population and rising costs for health care will, in the absence of other changes, steadily push spending up."[9] This year alone, Medicare will spend $478 billion — and over the next 10 years it will spend more than $7 *trillion*.[10] In just 7 years, Medicare spending will eclipse the entire national defense budget.[11] And the program is projected to grow much faster than the economy, government revenues, or the population for decades to come. According to the 2012 Trustees Report, "[g]rowth of this magnitude, if realized, would substantially increase the strain on the nation's workers, the economy, Medicare beneficiaries, and the federal budget."[12]

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[7] American Enterprise Institute: *Competitive Bidding Can Help Solve Medicare's Fiscal Crisis*. February 2012. Available online at: http://www.aei.org/outlook/health/healthcare-reform/competitive-bidding-can-help-solve-medicares-fiscal-crisis/.

[8] Congressional Budget Office: *March 2012 Medicare Baseline*. Available online at: http://cbo.gov/sites/default/files/cbofiles/attachments/43060_Medicare.pdf.

[9] Congressional Budget Office Director Doug Elmendorf: *Fundamental Fiscal Challenge: Rising Health Care Costs*. February 1, 2012. Available online at: http://www.cbo.gov/publication/42914.

[10] Office of Management and Budget: *FY2013 Budget of the U.S. Government*. February 2012. Available online at: http://www.whitehouse.gov/sites/default/files/omb/budget/fy2013/assets/budget.pdf.

[11] Ibid.

[12] Medicare Trustees: *2012 Annual Report*. April 23, 2012. Available online at: http://www.cms.gov/Research-Statistics-Data-and-Systems/Statistics-Trends-and-Reports/ReportsTrustFunds/Downloads/TR2012.pdf.

To make matters worse, Medicare's financing structure is not equipped to handle these future budgetary pressures. For a single-earner couple, the program spends six dollars in benefits for every dollar it collected in payroll taxes.[13] On a programmatic basis, Medicare has run cash flow deficits in all but two years (1966 and 1974) of its existence.[14] According to the Medicare Trustees, Medicare received $264.1 billion from dedicated financing sources (payroll taxes and beneficiary premiums), but it spent $549.1 billion on benefits last year.[15] *To put it simply, Medicare operated in the red by a $285 billion margin last year alone.* This level of fiscal imbalance prompted the Medicare Trustees to issue a "Medicare funding warning" for the seventh consecutive year.[16]

Advocates of the President's Patient Protection and Affordable Care Act (PPACA) claim that the law "extended the life of the Medicare Trust Fund" and "strengthened Medicare." Unfortunately, the facts suggest a different conclusion. PPACA cut future Medicare spending by $716 billion and increased HI taxes by $318 billion, but these funds were not reinvested into the Medicare program.[17] Rather, these savings were spent exclusively on the President's priorities of expanding the Medicaid program and creating another government subsidy program.[18] According to the non-partisan CBO, "… *unified budget accounting shows that the majority of the HI trust fund savings under PPACA would be used to pay for other spending and therefore would not enhance the ability of the government to pay for future Medicare benefits*."[19] Unfortunately, rather than improving the health of the Medicare program, the President chose to spend Medicare funding on another new government program.

A Vision for Strengthening Medicare

To preserve Medicare, the program must be reformed. The status quo is unacceptable both for the current seniors who would inevitably suffer from a weakened program and current workers whose tax burden would increase substantially if structural improvement are not implemented. Reforms should protect seniors — and they should be both fair and sustainable. Those Americans who planned their retirement around Medicare deserve the peace of mind that Washington will keep its promise. The program must be able to pay its bills to deliver on guaranteed benefits.

Reforms should draw upon bipartisan, market-oriented solutions such as a competitive system of bidding among traditional Medicare and carefully-regulated private plans. Rather than having politicians, lobbyists, and bureaucrats in Washington determine how much guaranteed Medicare benefits should cost, that amount could be determined

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[13] Urban Institute: *Social Security and Medicare Taxes and Benefits over a Lifetime*. June 2011. Available online at: http://www.urban.org/UploadedPDF/social-security-medicare-benefits-over-lifetime.pdf.
[14] Holtz-Eakin, D. and Nussle, J.: *Medicare's Dirty Little Secret*. April 25, 2012. Available online at: http://www.nationalreview.com/articles/296901/medicare-s-dirty-little-secret-douglas-holtz-eakin.
[15] Medicare Board of Trustees: *2012 Annual Report*. April 23, 2012. Available online at: http://www.cms.gov/Research-Statistics-Data-and-Systems/Statistics-Trends-and-Reports/ReportsTrustFunds/Downloads/TR2012.pdf.
[16] Ibid.
[17] CBO: *Letter to John Boehner providing an estimate for H.R. 6079*. July 2012. Available online at: http://cbo.gov/publication/43471.
[18] See footnote 2
[19] Congressional Budget Office: *Additional Information on the Effects of the Patient Protection and Affordable Care Act on the Hospital Insurance Trust Fund*, January, 2010.

through a robust competitive process. Seniors would then be free to choose — based on transparent cost and quality information — whether they prefer support for traditional Medicare or a private health plan. More than 13 million seniors across the country have already chosen to receive their care through Medicare Advantage (MA), a private health plan option. Relative to traditional, government-run Medicare, these plans typically offer better benefits, enhanced care coordination, and higher quality coverage. Sustainable Medicare reform would build on this success by holding these private health plans to a higher level of accountability through competitive bidding.

A number of different versions of competitive bidding reform have been offered over the years, but all share some basic features. In particular, they continue to provide seniors with a guaranteed, comprehensive Medicare benefit while reducing the government's costs and preserving the quality of care. This approach would use the Medicare program's immense financial leverage to drive providers to compete for seniors' business. The federal government would continue to define a package of required benefits that would constitute comprehensive Medicare coverage, as it does today. But each year, private insurers and traditional Medicare would submit bids to provide guaranteed Medicare benefits. The government would then provide, on behalf of each senior, a premium support payment based on those competitive bids in their area of the country. Seniors who chose plans that cost less than the government payment would get the difference back through lower premiums or additional health benefits. Every senior would be guaranteed a comprehensive coverage option that costs no more than under traditional Medicare today. More importantly, seniors would have other options that might cost even less.

Seniors already benefit from this type of structure in the Medicare prescription drug benefit (Part D). The idea behind competitive bidding reform is to use the Part D model — which has been successful in containing costs and has been very popular with beneficiaries — for the larger program. Seniors would continue to have their choice among guaranteed, comprehensive coverage options while the government's costs could be significantly restrained.

A Bipartisan History of Competitive Bidding

Over the years, variations of a competitive bidding concept have been proposed by respected and thoughtful policy innovators across the ideological spectrum. The core concept has included a well-regulated market for competing plans, risk-adjusted payments on behalf of beneficiaries, and government contributions based on the cost of guaranteed Medicare benefits. Under such a system of managed competition, private plans would be prohibited from discriminating on the basis of seniors' pre-existing medical conditions.

Proponents trace the origin of this concept to a 1978 managed competition proposal from Stanford University economist Alain Enthoven. Dr. Enthoven wrote, "[m]edical costs are straining public finances. Direct economic regulation will raise costs, retard beneficial innovation and be increasingly burdensome to physicians. As an alternative, I suggest that the government change financial incentives by creating a system of

competing health plans in which physicians and consumers can benefit from using resources wisely."[20] Similarly, Dr. Henry Aaron of the Brookings Institute and Dr. Robert Reischauer of the Urban Institute wrote in 1995, "Medicare costs are rising faster than projected revenues. Action to close the emerging deficit is inescapable. We propose converting Medicare from a 'service reimbursement' system to a 'premium support' system. These changes would resemble many that are now reshaping private employer-based insurance. Our reform would encompass not just the 'public' Medicare program but also the 'real' Medicare, which includes the supplemental plans to which most Medicare beneficiaries have access."[21]

In addition to support from policy experts, the concept has been championed by political leaders on both sides of the aisle. In 1983, the House Democratic Leader Richard Gephardt proposed the bipartisan National Health Care Reform Act (H.R. 850), which included a premium support model for Medicare beneficiaries.

Years later, Congress created the National Bipartisan Commission on the Future of Medicare in the Balanced Budget Act. In 1999, the Commission co-chairs, U.S. Senator John Breaux (D-LA) and U.S. Representative Bill Thomas (R-CA), released their recommendations to "strengthen and improve" Medicare in time for the retirement of the "Baby Boomers." Specifically, the bipartisan Commission's recommendations stated, "[w]e believe a premium support system is necessary to enable Medicare beneficiaries to obtain secure, dependable, comprehensive high quality health care coverage comparable to what most workers have today. We believe modeling a system on the one Members of Congress use to obtain health care coverage for themselves and their families is appropriate… Our proposal would allow beneficiaries to choose from among competing comprehensive health plans in a system based on a blend of existing government protections and market-based competition."[22] A bipartisan group of Senators, led by Senator John Breaux (D-LA) and Bill Frist (R-TN), later introduced the Commission's plan (S. 1895) in the U.S. Senate. Cosponsors of the bill included Members from across the political spectrum: Bob Kerrey (D-NE),[23] Kit Bond (R-MO), Judd Gregg (R-NH), Chuck Hagel (R-NE), and Mary Landrieu (D-LA).

Just months after the release of the Breaux-Thomas Commission report, President Bill Clinton proposed a major set of Medicare reforms with his own version of premium support, which he called a "*competitive defined benefit proposal*." President Clinton's National Economic and Domestic Policy Councils jointly released a detailed description of the plan, and the specifications are still relevant for today's proponents of Medicare premium support: "The government would pay Medicare managed care plans based on their prices, not a flat rate based on a statutory formula, as it does today. These Federal payments would be limited so that the government does not pay more than it does today (in general) but would be lower if beneficiaries choose lower-price plans. In

[20] New England Journal of Medicine: *Consumer-Choice Health Plan — A National-Health-Insurance Proposal Based on Regulated Competition in the Private Sector*. March 30, 1978. Available online at: http://www.nejm.org/doi/full/10.1056/NEJM197803302981304.
[21] Aaron, H.J. and Reischauer, R.D.: *The Medicare reform debate: what is the next step?* Volume 14, No. 4, 1995. *Health Affairs*.
[22] National Bipartisan Commission on the Future of Medicare: *Building a Better Medicare for Today and Tomorrow*. March 16, 1999. Available online at: http://rs9.loc.gov/medicare/bbmtt31599.html.
[23] Former Senator Kerrey is currently running for his old Senate seat representing the State of Nebraska.

other words, the government would save money when beneficiaries choose efficient plans, which does not happen in today's system. This should produce long-run efficiency and program savings if beneficiaries take advantage of the option to pay lower Part B premiums by enrolling in high-quality, cost-effective managed care plans."[24]

Despite the heated rhetoric of this election season, there remains bipartisan support for a competitive bidding reform of Medicare. Alice Rivlin, Director of the Office of Management and Budget for President Clinton, recently worked with former Senator Pete Domenici (R-NM) on the Protect Medicare Act. The bipartisan pair stated, "[s]imply put, there can be no lasting solution to the U.S. debt crisis without structural changes in the Medicare program to slow its cost growth. This can be accomplished through our proposal to transition Medicare to a 'defined support' plan in 2016. Such a system would provide strong incentives to increase the efficiency and effectiveness of health care delivery to seniors without abolishing current Medicare or forcing any beneficiary to move to a different plan."[25]

Another bipartisan team, U.S. Senator Ron Wyden (D-OR) and U.S. House Budget Committee Chairman Paul Ryan (R-WI), developed a premium support plan "to preserve the Medicare guarantee of affordable, accessible health care for every one of the nation's seniors for decades to come." According to an official Wyden-Ryan summary, "[o]ur plan would strengthen traditional Medicare by permanently maintaining it as a guaranteed and viable option for all of our nation's retirees. At the same time, our plan would expand choice for seniors by allowing the private sector to compete with Medicare in an effort to offer seniors better quality and more-affordable health care choices."[26]

Even key health advisors to President Obama agree that competitive bidding proposals will work. The *National Journal* recently reported, "[o]ne private e-mail exchange illuminates this point well. In e-mail exchanges with the staff of the White House-appointed fiscal commission that were obtained by *National Journal*, David Cutler and Jonathan Gruber, who have both advised Obama, gave qualified support to a Medicare… plan offered by Ryan and former Clinton budget director Alice Rivlin in talks to reduce the deficit."[27]

A Proven Record of Increasing Patient Satisfaction while Reducing Costs

Some insist that giving seniors a choice about how they receive their health benefits is burdensome and confusing. Yet, the data, and experience, indicate otherwise. For example, more than 13 million seniors — one out of every four enrolled — have chosen

[24] National Economic Council/Domestic Policy Council: The President's Plan to Modernize and Strengthen Medicare for the 21st Century. July 2, 1999. Available online at: http://clinton4.nara.gov/WH/New/html/Medicare/index.html.
[25] Bipartisan Policy Center: *Domenici-Rivlin Protect Medicare Act*. November 1, 2011. Available online at: http://bipartisanpolicy.org/sites/default/files/D-R%20Protect%20Medicare%20Act.pdf.
[26] Wyden and Ryan: Guaranteed Choices to Strengthen Medicare and Health Security for All: Bipartisan Options for the Future. December 2011. Available online at: http://budget.house.gov/uploadedfiles/wydenryan.pdf.
[27] National Journal: *Mixed Messages from Obama Advisors on Medicare*. September 10, 2012. Available online at: http://www.nationaljournal.com/healthcare/mixed-obama-message-on-medicare--20120910.

to enroll in private Medicare Advantage plans as an alternative to traditional, government-run Medicare. (Unfortunately, the President's health care law cut $308 billion from the Medicare Advantage program, which will cut future enrollment and additional benefits in half once fully phased in.) In Medicare Part D, a program that offers its beneficiaries a choice between 25 and 36 different plans, beneficiaries report high satisfaction.[28] Not surprisingly, this choice of competing plans is the same model offered to Members of Congress through the Federal Employee Health Benefit Program.

The empirical evidence of this approach for cost reduction without harming the beneficiaries is strong. Competitive bidding can be understood as making Medicare Part C look more like Medicare Part D. The prescription drug benefit (Part D) is delivered through private plans that contract with Medicare, and the payments to plans are determined through a competitive bidding process. Enrollee premium support levels are then tied to plan bids. By harnessing market forces, the Medicare Trustees estimate that Part D has come in 40 percent under budget, making it the rare — if not the only — government program to have come in so significantly under budget.[29] Similarly, a new Center for Medicare and Medicaid Services (CMS) report on durable medical equipment indicates that a competitive bidding approach to payments resulted in savings of approximately 42 percent.[30] CBO has acknowledged that this competitive dynamic can result in measurable savings when it comes to health plans as well.[31]

The data show that contrary to the arguments of some, traditional, government-run Medicare is not inherently cheaper than care offered through private plans. Based on experience with Medicare Advantage, private health plans can provide the exact same benefits as fee-for-service Medicare, but at a lower cost. According to the Medicare Payment Advisory Committee, enrollment-weighted private plan bids averaged 98 percent of fee-for-service spending, while HMO plans averaged just 95 percent of fee-for-service.[32] An academic analysis of the Ryan-Wyden plan found that the benchmark private plan would bid an average of 9 percent lower than fee-for-service costs. This is not limited to a few regions. Rather, across the country "68% of traditional Medicare beneficiaries in 2009 (approximately 24 million beneficiaries) lived in counties in which traditional Medicare spending was greater than the second-least expensive plan…"[33]

When private plans are allowed to compete with fee-for-service, experts believe that substantial savings would accrue to the Medicare program — even under the most conservative scoring conventions. The Breaux-Thomas Commission found that a

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[28] MedPAC: *Status Report on Part D with focus on beneficiaries with high drug spending*. March 2012. Available online at: http://www.medpac.gov/chapters/Mar12_Ch13.pdf.

[29] Medicare Board of Trustees: *2012 Annual Report*. April 23, 2012. Available online at: http://www.cms.gov/Research-Statistics-Data-and-Systems/Statistics-Trends-and-Reports/ReportsTrustFunds/Downloads/TR2012.pdf.

[30] CMS: *Competitive Bidding Update – One Year Implementation Update*. April 17, 2012. Available online at: http://www.cms.gov/Medicare/Medicare-Fee-for-Service-Payment/DMEPOSCompetitiveBid/Downloads/Competitive-Bidding-Update-One-Year-Implementation.pdf.

[31] CBO: *Selected CBO Publications Related to Health Care Legislation, 2009-2010*. December 2010. Available online at: http://cbo.gov/sites/default/files/cbofiles/ftpdocs/120xx/doc12033/12-23-selectedhealthcarepublications.pdf.

[32] MedPAC: *Health Care Spending and the Medicare Program*. June 2012. Available online at: http://www.medpac.gov/documents/Jun12DataBookEntireReport.pdf

[33] Song, Z., Cutler, D. M., and Chernew, M.E.: *Potential Consequences of Reforming Medicare into a Competitive Bidding System*. August 1, 2012. *JAMA*.

competitive bidding model would result in $100 billion in savings over the first 10 years and eventually achieve savings of $500-700 billion annually.[34] CBO found that a premium support system could save Medicare approximately $160 billion over a ten-year period.[35] More recently, the Bipartisan Policy Center estimated that the Domenici-Rivlin proposal would save $175 billion over the 2016-2022 budget window.[36]

A comprehensive evaluation of the Wyden-Ryan competitive bidding published by AEI found that these reforms could save $339 billion over ten years without disrupting seniors' premiums. According to the analysis, "…the elderly would not be exposed to the risk of higher health care costs…all seniors would have access to at least one health plan offering the standard set of benefits at no more than the Part B premium that seniors currently pay."[37] Richard Foster, chief actuary of the Medicare and Medicaid programs, has said such an approach "can get you to the lowest cost consistent with good quality of care."[38] Realistic, evidence-based, and market-oriented policies will allow Congress and the President to reform Medicare before it is too late.

A Choice of Action or Abdication

Medicare as we know it cannot continue absent significant improvements. To pretend otherwise jeopardizes both the health of seniors and the nation's long term fiscal position. Medicare is collapsing under its own weight, putting seniors' access to health care at risk and undercutting the ability of current workers to save and plan for the future. There are really only two basic choices for reforming the program: centrally-planned mechanisms that empower politicians, lobbyists, and bureaucrats – like the Independent Payment Advisory Board; or a market-based structure that empowers seniors and promotes the power of individual choice – such as the competitive bidding reforms. Bipartisan leaders over the last three decades have proposed empowering individuals and driving system savings through robust competitive bidding. The state of the Medicare program demands action and the time for action is now.

[34] National Bipartisan Commission on the Future of Medicare: *Cost Estimate of the Breaux-Thomas Proposal*. March 1999. Available online at: http://rs9.loc.gov/medicare/cost31499.html.
[35] CBO: *Budget Options Volume I: Health Care*. December 2008. Available online at: http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/99xx/doc9925/12-18-healthoptions.pdf.
[36] Bipartisan Policy Center: *Domenici-Rivlin Protect Medicare Act*. November 2011. Available online at: http://bipartisanpolicy.org/sites/default/files/D-R%20Protect%20Medicare%20Act.pdf.
[37] American Enterprise Institute: *Competitive Bidding Can Help Solve Medicare's Fiscal Crisis*. February 2012. Available online at: http://www.aei.org/outlook/health/healthcare-reform/competitive-bidding-can-help-solve-medicares-fiscal-crisis/.
[38] Foster, R.: Testimony before the House Budget Committee, July 14, 2011. Available online at: http://www.youtube.com/watch?v=Z__m5lYoJBg.