

# Medicare without Magic

Mark Pauly

Wharton School

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# The Past of Medicare

- ◆ Medicare has been highly politically popular for 40+ years.
- ◆ No wonder, given the good deal for seniors made possible by favorable demographics.
- ◆ The widespread popularity seems limited to the form of public financing, not the government management of benefits—people switch from public to private and vice versa for relatively small net gains.

# The (Grim) Future of Medicare

- ◆ Medicare's total and tax financed burdens are projected even by the most optimistic to grow over the next 30+ years, and to double or triple.
- ◆ This is due to the demographic reversal.
- ◆ But we could guarantee today's real benefits per beneficiary nearly forever at about today's tax rates.
- ◆ What blows up the financing: the so-far unstoppable cost of beneficial but costly new technology.

# Some Good News

- ◆ Americans are living longer than ever before, even based on life expectancy at age 60.
- ◆ This is partly because of lifestyle changes but partly because of access to new beneficial but costly technology every year—a great big medical Christmas.
- ◆ But these successes, combined with a shift in preferences from child quantity to child quality, have caused a severe financial dislocation and cannot be sustained at anything like current taxes.

**TABLE 1**  
**Alternative Medicare Tax Rate Scenarios<sup>1</sup>**

| Proportion of population means-tested as “non-low-income” | Real growth in Medicare spending per non-means-tested beneficiary | 2035 tax rate as percent of GDP |
|---|---|---------------------------------|
| 0   | Zero  | 2.6 <sup>2</sup>                |
| 0   | GDP + 1% (approx. 2.8%)   | 6.0 <sup>3</sup>                |
| 0   | Historical (4.7%)   | 10.2                            |
| 60  | GDP – 1%  | 3.3                             |

<sup>1</sup> Pauly, 2004; calculations based on the 2004 Annual Report of the Boards of Trustees, Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds, Table II-A-2.

<sup>2</sup> Equivalent to 5.2 percent tax on payroll, assuming a constant ratio of taxable wages to gross domestic product (GDP).

<sup>3</sup> Assumes that the GDP growth rate equals the “excess” Medicare population growth rate.

# How to deal best with a difficult choice

- ◆ Don't ignore it: at today's speed and direction it will be easier to turn the wheel gradually beginning sooner rather than give it a yank at the last minute.
- ◆ Protect current and immediate beneficiaries, and those who are poor.
- ◆ But put in place a mechanism for 50-somethings and younger to choose how they will contain the tax burden and deal with a fixed subsidy when they get to 65 and beyond.

# Beneficiary Choice: How far can it go?

- ◆ The basic plan: fund Medicare with a slightly more explicit (and risk adjusted) voucher than at present, which is set to grow at a sustainable rate.
- ◆ Allow beneficiaries to choose plans with different planned rates of growth in spending/technology—including zero.
- ◆ Offer both public and private plans (at different planned growth rates).
- ◆ Let people choose in an incentive-neutral setting

# How This Might Work

- ◆ Alternative public and private plans announce various cost effectiveness thresholds for new technology, and the mix of cost sharing, managed care, and insurance design they will use to meet them, OR:
- ◆ Have plans announce growth targets and say how they will limit/ration to meet them.
- ◆ You can choose not to choose, or to let others choose for you, if that is what you prefer.
- ◆ Consumers can choose plans that do not make them or even let them choose, but also plans where they can be heavily involved.

# Why Is This Trip Necessary?

- ◆ There is no plausible scenario that does not require curtailing the real growth per beneficiary; it only a question of how best to administer the bitter medicine.
- ◆ My intuition, and empirical evidence, confirm that people have varying preferences about which rationer they will employ.
- ◆ The alternative of a single public rationing strategy, even if selected in a good public choice setting, is probably inferior. This is the argument worth having.

# Some Technical Considerations, Puzzles, and Outrageous Proposals

- ◆ It will be hard to have a level playing field with a large public plan: avoid monopsony by breaking up traditional Medicare based on Soc Security numbers?
- ◆ Hardest to think of a competitive market in coverage of patent protected drugs.
- ◆ The financial viability of private alternatives to traditional Medicare seems knife-edged. Why?

# Thinking Straight and Being Cautious

- ◆ I do not attribute any strong technical efficiency advantages to private plans. If they exist, fine, but do not bet on it.
- ◆ There may be ways in which we “could” cut Medicare costs now but few ways in which we know we “can.” And even 30% savings only buys you 5 good years.
- ◆ The biggest advantage of markets is their ability to deal well with diversity of preferences and situations.

# Conclusion

- ◆ A market-like arrangement already exists in the Medicare program though may require some tweaking (and bravery) by policymakers. It needs to be recognized, praised, and explicitly made permanent.
- ◆ Check ideology at the door: public and private plans should compete, not be anointed.
- ◆ An incentive neutral (means tested) system with a variety of choices is the best way to deal with Medicare's constrained future.