

# 19. Medicare

**M**EDICARE, the government health program for seniors and disabled citizens, faces insolvency as baby boomers approach retirement. With 43 million elderly and disabled people currently enrolled, the program is composed of four elements: Medicare Part A covers hospitalization; Part B covers doctor and outpatient hospital visits; Part C is Medicare Advantage, a new system of private plans that provide Part A and Part B benefits; and Part D is the new prescription drug entitlement. This universal Medicare drug entitlement, enacted in 2003, has dramatically worsened the program's financial woes, threatening future generations with trillions of dollars in debt and many working and retired Americans with the loss of their existing drug coverage.

by *Robert E. Moffit, Ph.D.*

## Notes

### Recommendations

**1. Transform the enormously expensive drug benefit into a targeted benefit for low-income seniors who lack coverage.** No evidence in the professional literature supports the contention that most seniors lack access to prescription drugs. Instead of the universal entitlement, Congress should permanently resurrect the Medicare drug discount card program (which expired in 2006) and use the cards to channel assistance to low-income seniors who are without coverage. Private plans should also be able to integrate the drug discount card program into their benefit designs. Unspent subsidies on the cards should be carried over tax-free, from year to year, like the funds in Health Savings Accounts (HSAs). Alternatively, Congress could modify the subsidies and co-payments within the drug entitlement and provide significantly lower subsidies for upper-income retirees.

**2. Expand means testing throughout the entire Medicare program.** Generally, beneficiaries pay only 25 percent of the Part B premium, and the government pays the rest. In 2003, Congress enacted means testing for Part B premium payments: Beneficiaries with annual incomes in excess of \$80,000 (for an individual) or \$160,000 (for a couple) would pay higher premiums. This should apply to all of Medicare, particularly Part D. Medicare covers a diverse population, and more than 21 percent

of senior households (according to Current Population Survey data) earn \$50,000 or more per year.

**3. Establish a new system for those retiring in or after 2011, modeled on the Federal Employees Health Benefits Program.** Congress rejected this option in 2003 and reduced the idea to a “demonstration project.” Beginning in 2010, six large metropolitan areas will test a system of competitive private plans within Medicare, modeled on the FEHBP. But reform cannot wait that long. Congress should act now to create this new system for baby boomers. Retirees with private or employer-based coverage should be allowed to carry that coverage into retirement and receive a government contribution to offset its cost. All private health plans that meet current statutory and regulatory requirements could be deemed automatically eligible to participate.

This policy would allow future retirees to choose their own health plans—all with integrated drug coverage—with far less bureaucracy and regulation than is true under Medicare today. The government contribution would reflect real market prices and be capped at an annual dollar amount. Beneficiaries could choose a more expensive plan if they wished but would pay the additional costs above the cap. Congress could let seniors keep any money they save by choosing lower-cost plans. This would intensify competition and also help control costs. Future retirees should also be able to select a different private plan or an HSA plan in place of traditional Medicare.

## Facts and Figures

■ According to a study published in *Health Affairs*, Medicare costs totaled \$335.5 billion in 2005 and are projected to reach \$420.1 billion in 2006 and \$792 billion in 2015.

■ Current tax revenues will not cover the rapidly rising costs of Medicare. Medicare's unfunded liabilities (promised benefits that are not financed) will reach \$29.9 trillion over the next 75 years, a shortfall that will require massive tax increases, unprecedented deficit financing, or severe benefit cuts.

■ If Congress were to raise the payroll tax to cover Medicare's unfunded liabilities over the next 75 years, the payroll tax would jump from the current 2.9 percent to 13.4 percent of earnings, threatening disposable income, economic growth, and jobs.

■ The new drug entitlement is characterized by massive central planning and government regulation, including 1,162 pages of regulations

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on the financing and delivery of prescription drugs. This is not a true market-based program.

■ The major fiscal impact of Part D is to shift funding for drugs from the private sector to the public sector.

■ Part D is strange and complex. Beneficiaries pay a monthly premium and a deductible of \$250, as well as a coinsurance payment of 25 percent of drug costs up to the first-year (2006) limit of \$2,250. For costs ranging between \$2,250 and \$5,100, the beneficiary is responsible for 100 percent of expenditures, creating a “donut-hole” without coverage for millions of seniors.

■ Part D’s design has increased pressure to impose price controls on prescription drugs, which would imperil the development of future generations of lifesaving drugs. Letting the government “negotiate” drug prices would have the same effect.

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*This chapter can be read online at [issues2006.org/medicare](http://issues2006.org/medicare).*

## Notes

### Additional Reading

Tracy L. Foertsch, Ph.D., and Joseph R. Antos, Ph.D., “The Economic and Fiscal Effects of Financing Medicare’s Unfunded Liabilities,” Heritage Foundation *Center for Data Analysis Report* No. CDA05-06, October 11, 2005, at [www.heritage.org/Research/HealthCare/cda05-06.cfm](http://www.heritage.org/Research/HealthCare/cda05-06.cfm).

Robert E. Moffit, Ph.D., “High Anxiety: Implementing the Medicare Prescription Drug Program,” Heritage

Foundation *Backgrounder* No. 1860, June 14, 2005, at [www.heritage.org/Research/HealthCare/bg1860.cfm](http://www.heritage.org/Research/HealthCare/bg1860.cfm).

Walton J. Francis, “Using the Federal Employees’ Model: Nine Tests for Rational Medicare Reform,” Heritage Foundation *Backgrounder* No. 1675, August 7, 2003, at [www.heritage.org/Research/HealthCare/bg1675.cfm](http://www.heritage.org/Research/HealthCare/bg1675.cfm).