RESEARCH HIGHLIGHTS

Major Changes to Medicare Would Cut Costs but Also Squeeze Enrollment and Raise Spending for Seniors

Anticipated growth in Medicare spending over the next two decades casts an ominous shadow over the federal budget and the U.S. economy. The Affordable Care Act of 2010 made some changes to Medicare that are expected to curb spending. However, even with these changes, relentless cost growth looms. Medicare costs are projected to increase from 16 percent of federal spending in 2012 to 24 percent in 2037, equaling 6 percent of the U.S. gross domestic product (GDP). This increase is a major factor in the projected growth of the U.S. deficit. Faced with this grim prospect, policymakers are exploring ways to curb growth in Medicare spending.

A research team from RAND and other institutions (the University of Southern California, Precision Health Economics, and Harvard University) analyzed the potential effects of three large-scale policy changes intended to reduce Medicare cost growth:

- charging a premium for hospital inpatient (Part A) benefits
- changing Medicare to a premium support program in which seniors receive a credit toward the purchase of health insurance
- raising the Medicare eligibility age from 65 to 67.

The team estimated the effects of these proposals using the Future Elderly Model, a microsimulation model that tracks cohorts older than age 50 to project their health status and economic outcomes. The analysis found that each of these alternatives would slow Medicare cost growth but would also reduce enrollment in the program and increase spending for beneficiaries. Raising the eligibility age to 67 would have the most dramatic effect on costs—saving an estimated $1.2 trillion by 2036 (Figure 1)—but would also reduce enrollment more than the other options because 7.6 million seniors age 65–66 would no longer be eligible (Figure 2).

Key findings:

- **Charging a premium for Medicare Part A (hospital) benefits would save about $400 billion cumulatively between 2012 and 2036 but would reduce enrollment by 1.1 million.**
- **Changing Medicare to a premium support program would save approximately $900 billion cumulatively between 2012 and 2036. However, this change would reduce enrollment by 2.3 million and increase out-of-pocket costs for beneficiaries.**
- **Raising the eligibility age from 65 to 67 would save an estimated $1.2 trillion by 2036 but would reduce enrollment by 7.6 million.**

Charging a Premium on Hospital Benefits

One proposal for reducing Medicare costs is to begin charging a premium for hospital inpatient benefits (Part A). The analysis assumed that people with incomes below $85,000 would contribute a premium of 5 percent of expected Part A spending. The analysis further assumed that the percentage of Part A spending paid as premiums would increase as follows: to 10 percent for incomes of $85,001–$107,000, 15 percent for $107,001–$160,000, 20 percent for $160,001–$214,000, and 25 percent for incomes higher than $214,000. Income limits were double for couples, and no contribution was required from people who were dually eligible for Medicare and Medicaid because of their low incomes.

The analysis found that implementing a means-tested premium for Part A would save the program about $400 billion cumulatively between 2012 and 2036. However, enroll-

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Figure 1.
Policy Changes Would Save Medicare from $400 Billion to $1.2 Trillion Between 2012 and 2036 (net present value)

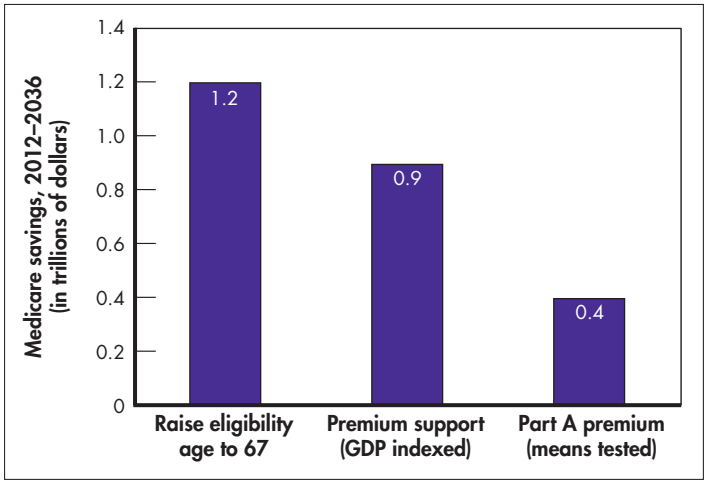
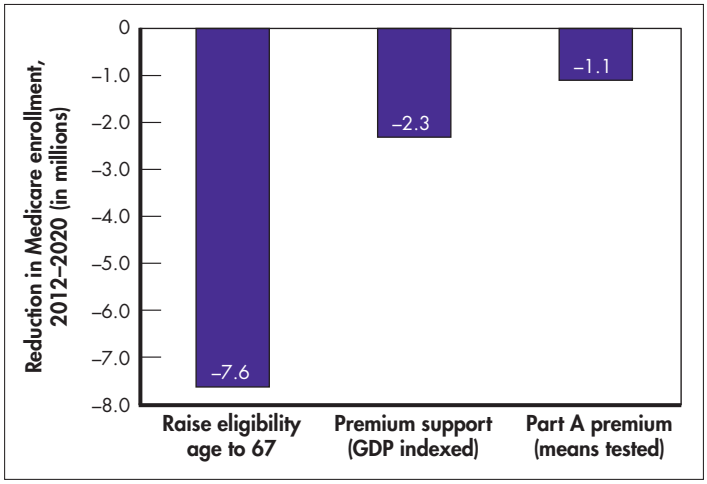


Figure 2.
…But Would Also Reduce the Number of Seniors Enrolled in Medicare, 2012–2020



ment in the Part A program would decline by an estimated 1.1 million seniors who either could not or would not pay the premium. In addition, out-of-pocket spending for those who remain enrolled would increase by the amount of the premium.

Changing Medicare to a Premium Support Program

Another widely discussed proposal, advanced in various forms in recent years, involves changing how Medicare delivers benefits. Currently, Medicare is a *defined benefit program*, in which beneficiaries are guaranteed coverage for a fixed set of benefits. Under a *premium support plan*, beneficiaries would receive a fixed payment to shop for their own insurance. The research team modeled a scenario in which Medicare beneficiaries received a credit that compensated them for current Part A and Part B (outpatient care) spending, minus the current Part B premium. In 2014, this credit would equal $8,900 per year for a person whose income is less than $85,000; the credit would cover about 85 percent of hospital and outpatient care.

The premium support plan would save approximately $900 billion cumulatively between 2012 and 2036. However, enrollment would decline by 2.3 million seniors. The proposal would also increase out-of-pocket costs for beneficiaries, who would have to pay the difference between the credit amount and actual cost of buying coverage.

Raising the Eligibility Age

The team also analyzed the effect of raising the eligibility age of Medicare from 65 to 67. This change would mirror current Social Security eligibility for full benefits among those born in 1960 or later. Of the three options, this one would have the most dramatic effect on costs—saving an estimated $1.2 trillion by 2036—but would also reduce enrollment by 7.6 million by 2020, substantially more than the other options. Nearly all of those no longer eligible to be on the program rolls would be seniors age 65 and 66, who would need to seek coverage elsewhere or be uninsured.

Implications for Policy

In considering whether to adopt any of these changes, policymakers must consider difficult trade-offs. Each option would reduce Medicare costs, but at the price of reducing enrollment in Medicare and, in the case of the Part A premium and the premium support scenarios, raising out-of-pocket costs for beneficiaries. The option that saves the most—raising the eligibility age—also reduces enrollment by the largest amount.

Ultimately, decisions about changes to Medicare will depend on policy goals. Is it preferable to provide generous benefits to a few or smaller benefits to many? Although analysis by itself cannot determine the best way forward, it can highlight the consequences of alternative paths to help inform difficult policy choices. ■

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