

**Insight on the Issues**

# Premium Support Is the Wrong Direction for Medicare

## *Highlights from a New Research Report*

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**INTRODUCTION**

In its 2018 budget plan for the federal government, the House of Representatives proposes to transform a program relied on by nearly all older Americans as well as many others. Under the proposal, Medicare—which provides health insurance to people ages 65 and older and to many younger people with disabilities—would become what’s termed a “premium support” program.<sup>1</sup> While much of the public have yet to digest what exactly this change would mean—or are even aware of the possibility of such a change—it would have vast implications for people with Medicare. Premium support would fundamentally change the way people with Medicare obtain their health coverage and how much they pay for it.

A new Urban Institute research report funded by the AARP Public Policy Institute offers important insights into how premium support would work in practice and why it would adversely affect people with Medicare. In *Restructuring Medicare: The False Promise of Premium Support*, Robert A. Berenson, Laura Skopec, and Stephen Zuckerman challenge assumptions underlying proposals for premium support and explain why premium support is likely to increase financial burdens for many people with Medicare.<sup>2</sup> Further, the report discusses how premium support is likely to reduce the choices of health coverage available to people with Medicare

compared with what’s available today through the Medicare Advantage and traditional Medicare programs.

This *Insight on the Issues* summarizes the key findings from the Urban Institute report.

**HOW PREMIUM SUPPORT WOULD WORK COMPARED WITH THE CURRENT PROGRAM**

Under a premium support system, the federal government would give each person with Medicare a fixed dollar amount of “premium support”—also called a defined contribution or voucher—to apply toward the purchase of health care insurance from competing private health plans. In most versions of premium support, traditional Medicare would also be available as a competing plan. Individuals with Medicare would pay a premium equal to the difference between the voucher amount and the price of the insurance plan they choose (whether a private plan or traditional Medicare).

For all individuals in a region, the defined contribution would be the same, but it would vary from region to region, depending on the prices of the insurance plans (including traditional Medicare) offered in each region.<sup>3</sup> Different formulas could be used to set the defined contribution amount. One approach under some proposals would be to base it on a region’s average price. Other proposals would limit yearly increases in the voucher amount using



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an index, such as one that measures general growth of the economy.

The price of traditional Medicare would also differ among regions, reflecting the wide locational variation in Medicare's average spending per person. Thus, because the price of traditional Medicare, as well as the defined contribution, would differ from region to region, people would pay different amounts for traditional Medicare depending on where they live.

The use of premium support would be a dramatic departure from the present Medicare system. Today, Medicare charges the same premiums nationwide, as determined by Medicare law, which guarantees traditional Medicare coverage. Individuals may choose to enroll in one of the private health plans (called Medicare Advantage plans) available in their location or to stay in traditional Medicare.

Medicare Advantage plans cannot charge enrollees extra for Medicare's guaranteed set of benefits, but plans that provide additional benefits may charge an additional plan-specific premium. Numerous plans provide extra benefits, such as lower cost sharing, without charging an additional premium. About a third of people with Medicare are currently enrolled in a Medicare Advantage plan; the other two-thirds have traditional Medicare.<sup>4</sup>

## KEY FINDINGS FROM THE URBAN INSTITUTE REPORT

### **A Major Restructuring of Medicare Is Not Needed**

Proponents of premium support argue that Medicare needs to be overhauled because the program is running out of money, but this claim is greatly exaggerated and radical restructuring of the program is not necessary. Numerous times over Medicare's history, the Hospital Insurance trust fund has been projected to reach insolvency within the same period—12 years—as current projections, but incremental policy changes have always ensured continued solvency.

The source of Medicare's funding challenges is not that of an inefficient program rife with out-of-control spending. Spending trends, in fact, counter such criticisms. Between 2010 and 2015, Medicare spending per person grew an average of 1.3 percent

per year—less than half the 3.2 percent per year growth rate of commercial insurance plans. The source of the challenge is a matter of a growing customer base—that is, the growing Medicare beneficiary population. Medicare enrollment is expected to grow significantly over the next decades as the baby-boom generation ages into the program.

Reports by the Congressional Budget Office, the Medicare Payment Advisory Commission, and other organizations have identified numerous opportunities for substantial spending reductions that do not require fundamental restructuring of the Medicare program.<sup>5</sup>

### **Premium Support Unfairly Puts Responsibility for Controlling Medicare Spending on Individuals**

While a premium support system could, in theory, lead to lower bids by health plans and thus reduce federal spending, it would place the primary burden and risk associated with health care cost increases on consumers. Growth in federal spending would be determined by growth in the defined contribution amount. Individuals could end up paying much higher amounts out of pocket for premiums and cost sharing, and be forced for financial reasons into plans that they would not otherwise choose.

Premium support would impose strong financial incentives—and potentially large financial burdens—on a vulnerable population. Most Medicare beneficiaries live on modest incomes and cannot afford to pay more for their health care. Half of individuals with Medicare had yearly incomes of less than \$26,200 in 2016.<sup>6</sup>

Premium support would force some individuals either to pay much more for their preferred option (traditional Medicare or their preferred private plan) or to choose a lower-priced plan. Many people with lower incomes may have to enroll in plans they otherwise would not choose, while only people with higher incomes may be able to afford the plans they prefer.

### **Premium Support Would Reduce Choices**

Premium support would reduce options for individuals compared with what they have today through the choice of a Medicare Advantage plan or traditional Medicare. Currently, the Medicare

Advantage program offers a variety of private plans in almost all locations; this occurs because the system is specifically designed so that people with Medicare almost always have a choice of a private plan or traditional Medicare.

In contrast, under premium support, people with Medicare would have fewer choices—and the options available would likely differ dramatically by location. In some regions, traditional Medicare would be significantly less costly than private plans, so private plans would have difficulty competing with it, potentially resulting in traditional Medicare becoming the only option.

In other regions, individuals would have to pay much higher premiums for traditional Medicare than for private plans, making traditional Medicare unaffordable for most people.

Another issue that, in practice, would reduce options stems from shortcomings in methods Medicare uses to adjust payment to private plans to account for differences in the health status of the plan's enrollees, known as risk adjustment. Risk adjustment is intended to ensure that plans that are paid a fixed dollar amount per enrollee receive payments that, on average, reflect the spending for the population enrolled in the plan—so a plan that has enrollees with greater health needs would receive payments that account for the higher spending on services for its population. But current methods of risk adjustment have flaws, and payments do not accurately reflect the mix of health statuses of the population in the plan. The consequence is that private plans can take advantage of these flaws to get higher payments than warranted.

The flaws in risk adjustment would have a larger impact in a premium support system because, in addition to private plans, payments to traditional Medicare would also be on a per-person, risk-adjusted basis. Currently, flaws in risk adjustment mean private plans are overpaid, on average, but traditional Medicare is not affected. Under premium support, if risk adjustment does not adequately reflect the spending of people with greater health needs enrolled in traditional Medicare, then traditional Medicare will be underpaid relative to private plans. In some regions, this unfair distortion could drive the

traditional Medicare program into having to charge ever higher and higher prices to cover the costs of its enrollees, effectively pricing out almost everyone who would otherwise have chosen traditional Medicare.

### **For Private Plans to Compete Successfully with Traditional Medicare, an Active Government Role Is Crucial**

Proponents of premium support assume that free-market competition among private health plans would lead to lower spending. What many people do not recognize, however, is that a key reason Medicare Advantage works well is because these private plans are able to pay hospitals, physicians, and other providers about the same payment rates as the traditional Medicare program—rather than having to pay them the much higher rates they get from commercial insurance plans. Medicare Advantage plans can do this because Medicare law prohibits providers from billing Medicare patients more than the rates allowed in traditional Medicare, giving Medicare Advantage plans negotiating power to obtain those same payment rates.

Without this active role for government in the market—one that proponents of Medicare premium support typically oppose—private plans under premium support would not be able to leverage as much control over the prices they pay to hospitals and other providers as Medicare Advantage plans do today. They would therefore potentially cost much more than today's private plans and have considerable difficulty competing with traditional Medicare.

### **Over Time, Premium Support Could Shift Larger and Larger Costs to Individuals**

A premium support model could produce savings for the federal government by limiting the updates in the defined contribution amount to a measure that is unrelated to health care, such as general economic growth (gross domestic product) per person, which is expected to grow more slowly than health care spending per person. If the defined contribution amount were constrained in this way, a larger and larger proportion of plan premiums would shift to individuals over time.

Earlier versions of premium support proposed this type of approach. More recent premium support proposals would better protect individuals (with

projected savings correspondingly declining) by basing updates in the defined contribution on changes in plan prices. However, if premium support were adopted, design features added to better protect individuals could be modified, with more costs shifted onto individuals.

## CONCLUSION

Proposals for restructuring Medicare as a premium support program raise serious concerns for people with Medicare now and in the future. As shown in the Urban Institute report, the premium support approach to competition would put numerous people in Medicare at risk for high out-of-pocket expenses. For affordability reasons, many people would be forced to enroll in a plan they would not otherwise choose. People in different locations across the country would receive different defined

contribution amounts and face significantly different out-of-pocket premiums for traditional Medicare.

Premium support would lead to fewer options for how individuals can obtain their health insurance coverage, compared with what is available now through private Medicare Advantage plans and traditional Medicare. In some locations, traditional Medicare's range of provider choice may be accessible only to affluent beneficiaries. In other locations, private plans may no longer be available.

The current combination of Medicare Advantage and traditional Medicare promotes private plan competition and offers a variety of options to individuals in nearly all locations. With continued improvements in both of these components, Medicare spending can be controlled without a drastic redesign.

- 1 *Establishing the Congressional Budget for the United States Government for Fiscal Year 2018 and Setting forth the Appropriate Budgetary Levels for Fiscal Years 2019 through 2027*. H.R. Con. Res. 71, 115th Cong. (as agreed to by House, Oct. 5, 2017). <https://www.congress.gov/bill/115th-congress/house-concurrent-resolution/71>.
- 2 Robert A. Berenson, Laura Skopec, and Stephen Zuckerman, *Restructuring Medicare: The False Promise of Premium Support* (Washington, DC: The Urban Institute, October 2017). <https://www.urban.org/research/publication/restructuring-medicare-false-promise-premium-support>.
- 3 Each plan's price would be based on covering a person with average health care needs; however, a premium support system would include a method for the federal government to "risk adjust" its payments to plans that enroll a population with above-average or below-average health care needs within its region. Thus, the government payment to a plan would be based on enrollees' health status, but the premiums individuals pay would not vary with health status.
- 4 Gretchen Jacobson, Anthony Damico, and Tricia Neuman, "Medicare Advantage 2017 Spotlight: Enrollment Market Update," Issue Brief, Kaiser Family Foundation, Washington, DC, June 2017, <https://www.kff.org/medicare/issue-brief/medicare-advantage-2017-spotlight-enrollment-market-update/>.
- 5 Congressional Budget Office (CBO), *Options for Reducing the Deficit: 2017 to 2026* (Washington, DC: CBO, 2016), <https://www.cbo.gov/publication/52142>.  
Kaiser Family Foundation (KFF), *Policy Options to Sustain Medicare for the Future* (Menlo Park, CA: KFF, 2013), <https://www.kff.org/medicare/report/policy-options-to-sustain-medicare-for-the-future/>.  
Medicare Payment Advisory Commission (MedPAC), "The Medicare Advantage Program: Status Report," in *Report to the Congress: Medicare Payment Policy* (Washington, DC: MedPAC, March 2016), 327-65, <http://www.medpac.gov/docs/default-source/reports/chapter-12-the-medicare-advantage-program-status-report-march-2016-report.pdf>.
- 6 Gretchen Jacobson, Shannon Griffin, and Tricia Neuman, "Income and Assets of Medicare Beneficiaries, 2016-2035," Issue Brief, Kaiser Family Foundation, Washington, DC, April 2017, <https://www.kff.org/medicare/issue-brief/income-and-assets-of-medicare-beneficiaries-2016-2035/>.

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