



AMERICAN ACADEMY *of* ACTUARIES

The Honorable William Roth
Chairman
Senate Committee on Finance
Room 219
Dirksen Senate Office Building
Washington, DC 20510

May 26, 1999

Re: Medicare "Premium Support" Proposals

Dear Senator Roth:

The American Academy of Actuaries commends you and your committee for addressing the long-term solvency of the Medicare program. Although the Academy is a nonpartisan professional organization that does not support or oppose specific legislative proposals, actuaries recognize that solutions for Medicare's financial problems will be less painful if adopted sooner rather than later, allowing for the grading of necessary charges over time. Therefore, the Academy urges Congress to take swift action to ensure the long-term stability of Medicare.

Some policy makers, including Sen. John Breaux and Rep. Bill Thomas, who served as the Co-Chairmen of the National Bipartisan Commission on the Future of Medicare, have expressed support for restructuring Medicare into a system of premium supports, along the lines of the Federal Employees Health Benefits Program (FEHBP). The FEHBP is a successful program that allows federal workers and retirees to choose from among a range of private health plan options whose premiums and benefits are set by the government. Although in some respects the FEHBP's experience may be useful in considering Medicare reforms, the FEHBP does not represent a completely analogous model for Medicare.

As you and your committee examine this proposal, you may wish to consider the following points:

(1.) Medicare's insured population—elderly and often in poor health—is quite different from the FEHBP's insured population, which is younger, more likely to be in the active work force, and thus generally healthier on average. Policy makers should use extreme care in drawing conclusions about the effects on aggregate plan costs of shifting Medicare to a system similar to the FEHBP.

(2.) Recent studies of Medigap experience show that giving participants a choice of health benefit plans increases costs for two reasons:

(a.) Individuals with costly health conditions tend to select plans with more generous benefits, even if their own premium contributions increase. This phenomenon is known as antiselection.

(b.) Participants with more generous supplemental benefits, such as coverage of prescription drugs, tend to use health care services more than if they did not have the supplemental benefits. This phenomenon is called induced utilization.

Thus, all else being equal, expansion of choice would probably increase the total cost of Medicare to government and to plan participants. There are, however, techniques which may be employed to offset these effects. These techniques include reducing the range of choices in benefit structures through the adoption of standardized benefit provisions. In addition, risk adjusting participant contributions for each plan would help. Using risk adjustment means that the contribution schedule would reflect the differing characteristics among plans, particularly the average condition of health of the participants as well as differing geographical and demographic characteristics. Furthermore, increased competition among plans may lead to increased efficiencies reflected in lower scheduled contributions for a given level of benefits.

(3.) Tying premium costs directly to income may aggravate some of the effects of antiselection. Studies suggest that lower income individuals tend to be in poorer health on average than higher income individuals. Greater premium subsidies might allow them to elect plans with more generous benefits than otherwise, depending on how the subsidies are structured.

(4.) It is currently proposed to delay Medicare's full eligibility age for coverage to match Social Security's eligibility age for full benefits. Increasing eligibility age will produce much smaller savings for Medicare than for Social Security. This is because a Social Security beneficiary's monthly cash benefit generally remains unchanged as the beneficiary ages except for annual cost of living increases based on the consumer price index. Medicare's experience is quite different. Medicare's costs increase as beneficiaries age and suffer from declining health with greater need for health care.

The Academy looks forward to working with your committee as you continue your consideration of Medicare reform. In particular, we are eager to offer more specific comments on premium support proposals as details are fleshed out. Some details could result in savings adequate to offset or avoid the effects normally resulting from giving health plan participants a range of choices among health plans. If you have any questions, please feel free to contact me.

Sincerely,

Dwight K. Bartlett III
Senior Health Fellow

cc: Members, Senate Finance Committee