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Why Private Insurance Vouchers Cannot Replace Medicare

Judith Feder, Georgetown University

A radical overhaul of Medicare is on the table, as Paul Ryan and his supporters aim to phase out guaranteed public insurance and instead give future senior citizens vouchers to pay for part of the cost of health plans offered by private companies. This is an untried idea, especially as applied to the elderly and disabled – so you would think the case for changing Medicare into vouchers would be made with solid evidence. Has Medicare done a poor job of controlling rising health costs? Is there evidence that competing private insurers do better?

Actually, the record shows exactly the opposite. To be clear, payment mechanisms in Medicare can be improved; all areas of U.S. health care coverage need reform, as the new health reform law starts to do. But compared to subsidized private insurance, Medicare's has shown impressive ability to deliver secure coverage to all of the elderly while bargaining for better prices. If we get rid of Medicare as we know it, Americans could end up paying more for less health security.

How Medicare Contains Costs without Cherry Picking

Health insurance spreads the risk of paying for costly care among many people, the more the better. Any given health insurance plan can limit cost and price increases in one of two ways – by delivering care to everyone more efficiently or by "cherry picking" people to include, for instance by attracting participants who are relatively healthy and avoiding those who are prone to more illnesses. Obviously the first method is better from the point of view of all citizens and patients, and Medicare outperforms private insurance on this high road to cost containment.

- Medicare does a terrific job at pooling risks without regard to elderly people's health status. Private insurers, in contrast, often make money (as their shareholders rightly expect) by avoiding the sick. Competing private plans have many ways to do this, for example by advertising in wealthier places or tailoring benefits to attract healthier customers. Only the most aggressive government oversight can prevent private insurers from collecting taxpayer subsidies while cherry picking customers – and that kind of oversight rarely happens. In fact, the same people who now call for getting rid of traditional Medicare are among the loudest opponents of effective government regulation!

- The bigger and more inclusive a health plan is, the more effectively it can bargain for good prices from hospitals, health care professionals, and pharmaceutical manufacturers and medical equipment companies. Tens of millions of purchasers in a single pool give Medicare the edge in dealing with providers who are increasingly concentrated and bargain hard for high payments. Medicare pays hospitals about 30 percent less and physicians about 20 percent less than private insurers pay. Most providers accept what Medicare pays because they can't live without the paying patients Medicare offers. But private insurers may not have the clout or the determination to get the best prices. If America wants to contain rising health costs, it makes no sense to destroy Medicare's purchasing advantage.

Alternative Ways to Control Government Costs

Medicare costs are rising for two different reasons – and it is important to sort them out. On the one hand, costs rise for Medicare and all health plans to the degree that prices for medical care go up faster than overall inflation or economic growth. On the other hand, any program for older retirees will see rising costs if more people live into old age – in principle, a good thing!

Critics and budget hawks are worried about projected big increases in total Medicare spending (which is expected to rise 6.1 percent over the next ten years, faster than overall economic growth at 5 percent). But the main driver of this increase will be the rising number of Americans enrolled in Medicare, because starting this year the program is enrolling about a million and a half aging Baby Boomers every year. But when it comes to how much each new enrollee costs, Medicare's expenses are growing surprisingly slowly – more slowly than per capita economic growth and much more slowly than the growth in private health care spending. The recent health reform – the Affordable Care Act, sometimes dubbed ObamaCare – includes a series of reforms that are already reducing Medicare's cost to the taxpayers and extending the life of the program.

Overpayments to private insurance companies and providers have been cut by $700 billion over the next decade. Innovations in care and more effective mechanisms for paying hospitals and doctors for smart, well-coordinated care of patients are already doing their job to reduce prices.
Medicare cost increases are now projected to be very effectively controlled compared to private insurance. Paul Ryan and his supporters want to repeal the ObamaCare reforms along with transforming traditional Medicare into vouchers. That means they want to give up these big cost savings – and put in place a very different approach to cutting Medicare spending.

What is their alternative? Simply put, it is to limit spending on the new vouchers that would be given to senior citizens to shop for private insurance, and hope that competing private insurance companies would both cover everyone and cut prices. Previous experience with subsidizing private insurers suggests that, in reality, costs could rise quickly. If that happens, under the Ryan voucher plan the government would cut costs by asking each senior citizen and his or her loved ones to pay more – the current estimates suggest about $6000 a year more – for the same coverage seniors now get under Medicare. And price increases in health care could shoot up without Medicare's bargaining leverage. According to nonpartisan estimates, the total price for all U.S. health care would rise. Government would pay a bit more, but seniors and other private citizens would pay much more.

Mend It, Don't End It

Some supporters of the Ryan overhaul are motivated by ideology – they just want government out of health care and have always opposed Medicare. But others worry about controlling rising government costs. That's a reasonable worry, but the way to achieve reductions is not to abandon public insurance that does a better job than private health plans at controlling costs. The nation's top health priority should be to implement the Affordable Care reforms, not to undermine broad risk-pooling and proven market clout of Medicare. Let's mend and build on Medicare, not end it.

Read more in Judy Feder, Paul Van de Water and Henry Aaron, "The Case against Premium Support," Brookings Institution, December 16, 2011.