Representative Ryan's $30 Trillion Medicare Waste Tax

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Contents

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Introduction

Representative Ryan's proposal[1] to replace the current Medicare system with a system of vouchers or premium supports has been widely described as shifting costs from the government to beneficiaries. However, the size of this shift is actually small relative to the projected increase in costs that would result from having Medicare provided by private insurers instead of the government-run Medicare system.

The Congressional Budget Office's (CBO) projections[2] imply that the Ryan plan would add more than $30 trillion to the cost of providing Medicare equivalent policies over the program's 75-year planning period. This increase in costs – from waste associated with using a less efficient health care delivery system – has not received the attention that it deserves in the public debate.

Creating Waste

One reason that $30 trillion in additional projected costs may have been overlooked is that many analysts used CBO's Alternative Fiscal projections, rather than current law for their comparisons with the Ryan plan.[3] The CBO projects that under current law (the Extended Baseline projection) Medicare costs will be considerably lower due to the health-care reform passed last year. This means that the Ryan plan offers much lower savings to the government when compared to the extended baseline that is in place as a result of the Affordable Care Act.

Figure 1 shows the annual cost of providing Medicare-equivalent policies to a typical 65-year-old under both traditional Medicare and under the Ryan plan. It also shows the portion of costs in both systems that would be paid by the government with the rest paid by beneficiaries.[4]

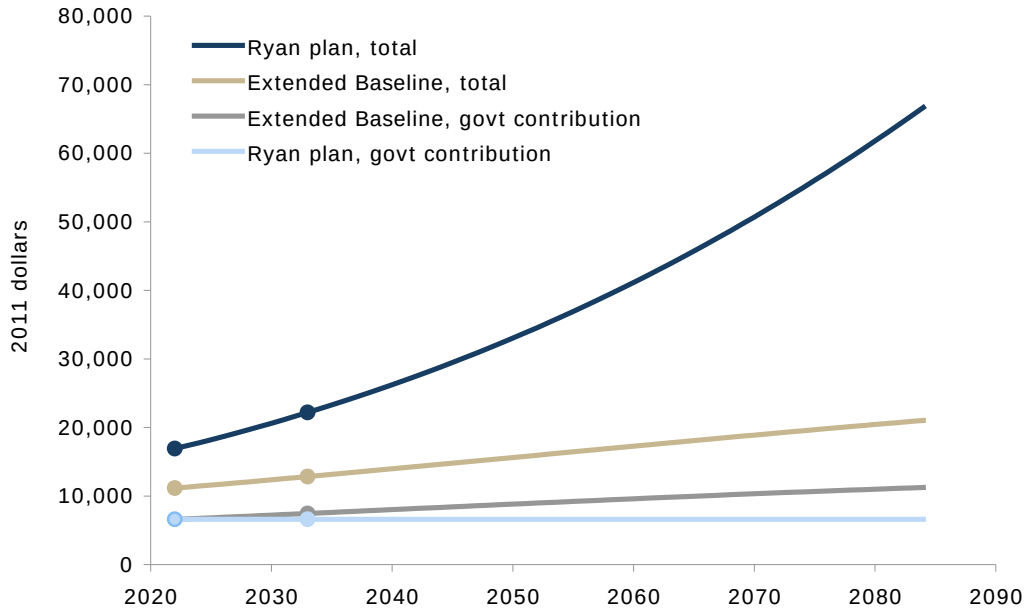
1 The bill was passed by the House of Representatives with almost unanimous support from Republicans and no votes from Democrats, on April 15, 2011.

2 Congressional Budget Office. 2011. "Long-Term Analysis of a Budget Proposal by Chairman Ryan." Washington, DC: Congressional Budget Office. Available at http://www.cbo.gov/ftpdocs/121xx/doc12128/04-05-Ryan_Letter.pdf.

3 Even using the Alternative Fiscal Scenario as the basis for comparison, the Ryan plan would still add more than $20 trillion to the cost of providing Medicare equivalent plans over the program's 75-year planning horizon.

4 See Appendix for discussion on how these numbers were derived from CBO data.

FIGURE 1
Costs of Medicare-Equivalent Policies and Government Contribution



Source: Congressional Budget Office and authors' calculations.

The difference between the value of the voucher in Ryan's plan (the light blue line) and the gray line representing the government's share of Medicare under CBO's extended baseline represent the savings to the government. The difference between the brown and dark blue lines represent the additional cost of providing equivalent coverage through private insurance rather than through Medicare – that is, the private-sector waste.

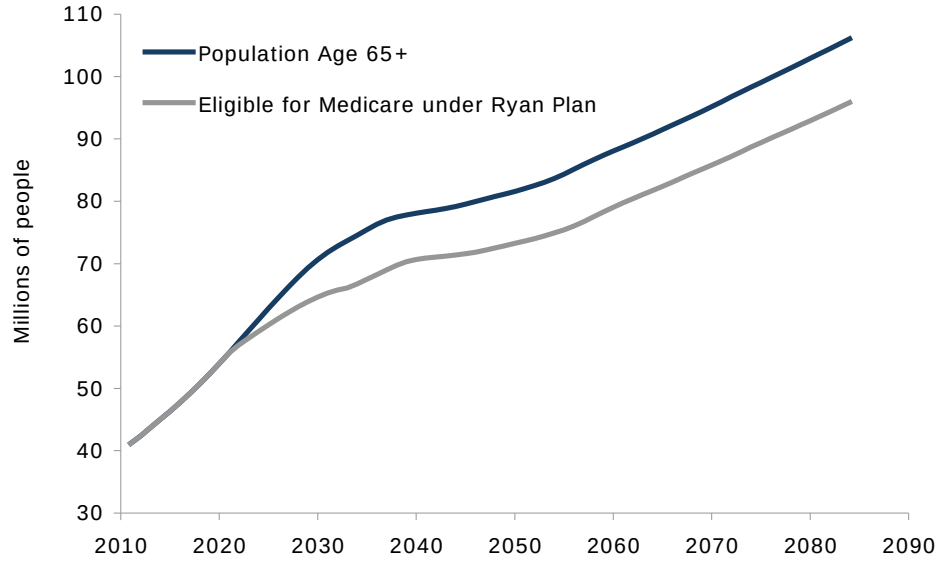
Based on the CBO data provided, the waste far exceeds the savings to the government. Under traditional Medicare, the government is expected to spend about $6,600 in 2022 on a typical 65-year-old, and the beneficiary is expected to spend $4,600 (all numbers in 2011 dollars). Under the Ryan proposal, a voucher for the same 65-year old would cost the government $6,600, saving the government nothing. However, the total cost of purchasing Medicare-equivalent insurance would be $16,900 – more than 50 percent higher than the $11,200 spent by the government and beneficiary combined under traditional Medicare. The difference of $5,700 represents a gift to the private sector.

CBO projects that private-sector inefficiency will grow over time. By 2030, the government would spend $7,200 on a 65-year-old in traditional Medicare. Since the cost of Ryan's plan remains fixed at $6,600, it would save the government $600. (Following CBO the cost calculation is shown for a hypothetical 65 year-old even though people would not be eligible at age 65 in years after 2022.) But the total cost of insuring the beneficiary through the private sector would be $20,600, compared to $12,400 under traditional Medicare. For every dollar that the government would save on this beneficiary, it would generate more than $13 of waste.

Shifting Costs to Seniors

The Ryan plan has another way of saving the government money, apart from shifting costs to beneficiaries. Ryan also proposes raising the retirement age for Medicare from 65 to 67, starting in 2022. **Figure 2** shows age-65-and-over population projections from the Social Security Trustees[5] and the number of people who would be old enough to qualify for any benefits under the Ryan plan. (Under the Ryan plan everyone who turns age 65 before 2022 is grandfathered into the traditional Medicare program for the rest of their lives.)

FIGURE 2
The Medicare Eligible Population: Baseline and Ryan Plan



Source: Social Security Trustees and authors' calculations.

By 2033, the Ryan plan fails to cover anyone between the ages of 65 and 67. While the Ryan plan would cover less than 30 percent of the cost of a 67-year-old's private health insurance, it would cover none of that of the 65-year-old. If the Ryan plan's increase in the age of eligibility goes into effect, a 65-year-old who bought into traditional Medicare plan in 2033 paying the full cost to the government would save more than 43 percent of the cost of buying Medicare-equivalent insurance due to the lower cost of getting insured through Medicare compared with private insurance. Traditional Medicare is almost entirely phased out by 2050.

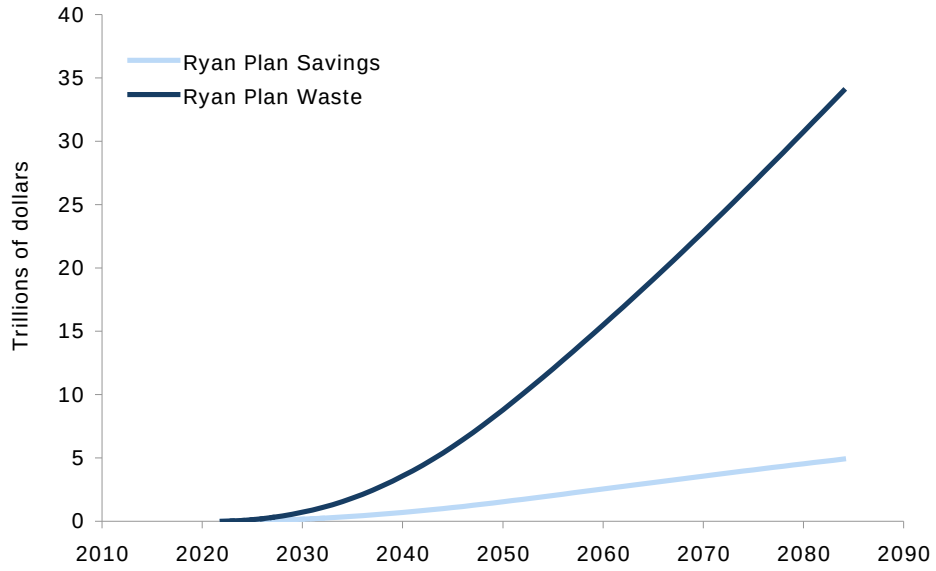
By gradually denying coverage to people up to age 67 and shifting costs off to those it would continue to cover, the Ryan plan saves the government $4.9 trillion from 2022 to 2084 – about the size of the Social Security shortfall over the same period. On the other hand, the private coverage is so expensive that the total cost is $34 trillion more than what would be paid under traditional

5 Annual data on the population by age was provided via email by Social Security. This data is consistent with the intermediate assumptions of the 2009 Social Security Trustees Report. Projections for the size of the over 65 population are also available from the 2010 Social Security Trustees Report, Table V.A2. http://www.ssa.gov/oact/TR/2010/lr5a2.html

Medicare. Seniors would be required to pay $39 trillion more under the Ryan plan – more than seven times the Social Security shortfall.

As seen in **Figure 3**, for every dollar of savings to the government under the Ryan plan, nearly seven dollars is wasted due to the inefficiency of private insurance relative to the traditional health care system.[6]

FIGURE 3
The Ryan Plan: Additional Health Care Waste and Costs Shifted to Beneficiaries



Conclusion

The CBO projections imply that the main effect of the Ryan plan will not be to shift costs from the government to Medicare beneficiaries. While there is projected to be a substantial shift of $4.9 trillion under the Ryan plan, this shift is dwarfed by the increase in overall costs due to the inefficiency of the private insurance system relative to the public Medicare system. The inefficiency of the private insurance system is projected to add more than $34 trillion to the cost of providing Medicare equivalent policies over the program's 75-year planning period. This amount is almost more than six times the size of the projected Social Security shortfall.

This additional cost can be thought of as a tax since raising the cost of Medicare due to increased waste has approximately the same effect as increasing the cost by imposing a tax. For this reason the Ryan plan will have a comparable economic impact to imposing a $34 trillion tax on health care for seniors, more than $100,000 for every man, woman, and child in the country.

6 Ryan also provides some means-testing of the top 8 percent of earners and provides some low-income support, but the latter would count as additional spending (lower savings to the government) and neither would change the amount of waste.

Appendix

Population projections for January 1 of each year by age were provided by Social Security and correspond to the Intermediate Assumptions of the 2009 Trustees Report. These were used to compute the average population age 65 and over, average population eligible for traditional benefits under the Ryan plan, and population eligible for vouchers under the Ryan plan by fiscal year. Eligibility for voucher benefits is assumed to start at age 65 and 2 months in calendar year 2022 and rise by two months every year until reaching 67 in 2033.

Age-65-cost-equivalent populations were computed based on the relative Personal Health Expenditures for ages 65-74, 75-84, and 85+ from the 2004 National Health Expenditures.[7]

The cost of an age-65 Ryan voucher was fixed at $6,600 in 2011 dollars, assuming 21.3 percent inflation from 2011 to 2022.[8] The cost of privately insuring a 65-year-old was derived from Figure 1 of CBO's analysis. From 2022 to 2030, the cost grows exponentially from 100/39 to 100/32 times the amount of the voucher. Thereafter, the rate of cost growth falls linearly at the rate of 0.7 percentage points over 63 years – the long-run rate of decline in excess costs assumed by CBO for Medicare absent health-care reform.[9]

Figure A below shows the data from CBO's Figure 1 along with the assumed trends derived from that data. All numbers are percentages of the cost of privately provided insurance equivalent to Medicare. That is, the light blue line shows the fraction of private insurance covered by the Ryan voucher. Because the cost of insurance is expected to grow much faster than inflation, and the voucher is held constant in real dollars, the voucher covers less and less of the total cost over time.

According to CBO, the total cost of Medicare for a typical 65-year-old will shrink from 89 percent of the cost of private coverage in 2011 to 66 percent in 2022 and 60 percent in 2030. The Medicare costs paid by the government will shrink a bit faster – from 54 percent of the total cost of private in 2011 to 39 percent in 2022 and 35 percent in 2030.

The benefit provided by Ryan's plan to a typical 65-year-old is frozen at 2022 levels, so is expected to fall relative to government spending on Medicare. By 2030, Ryan's plan would provide only 32 percent of the money needed to provide private insurance. Even though this is only three percentage points below what Medicare would spend, Medicare would come at a much lower cost overall. While a 65-year-old in traditional Medicare would have to pay 25 percent (the difference between the gray and dark blue lines) Ryan would have a 65-year-old in 2030 pay 68 percent – the difference between the light blue line and 100 percent. Together, the government and beneficiary by 2030 would pay 2/3 more for the typical 65-year-old under Ryan's plan than under traditional Medicare.

The cost of Medicare relative to private insurance was also derived from Figure 1 of the Ryan proposal, falling exponentially from 66 percent to 60 percent from 2022 to 2030 and at the same rate

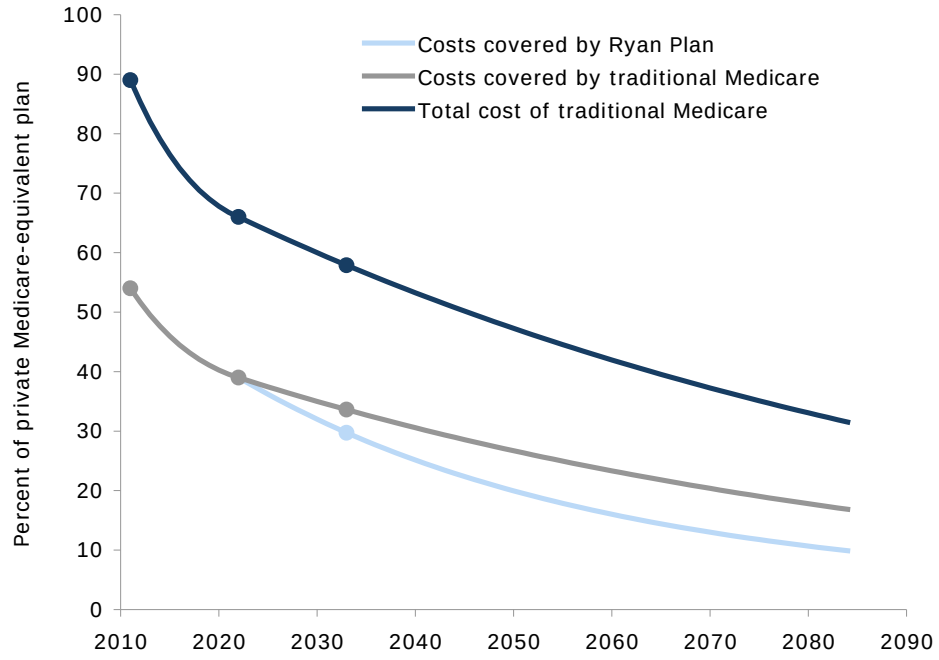
7 Centers for Medicare and Medicaid Services. National Health Expenditure Data. https://www.cms.gov/NationalHealthExpendData/downloads/2004-age-tables.pdf

8 CBO (2011). Such a voucher is estimated to be $8,000 in 2022 and held constant in real terms thereafter.

9 See footnote 4 of CBO (2011).

thereafter. The resulting real growth rate in the assumed total cost of Medicare for a 65-year-old falls from 1.3 percent in 2030 to 0.7 percent in 2084. (Following CBO the cost calculation is shown for a hypothetical 65 year-old even though people would not be eligible at age 65 in years after 2022.) This is seen in the dark blue line of Figure A.

FIGURE A
Payments Relative To Medicare-Equivalent Policy Under the Ryan Plan



Again based on Figure 1, the share of costs borne by the government under Medicare is assumed to grow exponentially from 39/66 in 2022 to 35/60 by 2030 and continue to grow thereafter. This is also shown in the gray points of Figure A above.

The annual costs to the government and beneficiaries were calculated for those who are age 65 and not eligible to participate in traditional Medicare (those turning 65 in 2022 and later.) For these, the costs under the Extended Baseline are equal to the costs under traditional Medicare. The costs to the government under the Ryan plan are equal to $6,600 times the age-65-cost-equivalent population eligible for vouchers, while the costs to the beneficiaries are the difference between total private and voucher costs for those eligible times the age-65-cost-equivalent eligible population plus the total cost of private insurance for a 65-year-old times the population eligible for traditional Medicare but not eligible under Ryan.

The savings to the government is the resulting government spending on Medicare under the Extended Baseline minus the government share of spending under Ryan. The private-sector waste is the total spending under Ryan, minus the total spending under the Extended Baseline. These real annual differences are summed up using a 3 percent discount rate over the period 2011-2084.[10]

10 The premium support portion of the Ryan plan would not begin until 2022, this analysis ignores the impact of other changes that take effect earlier, such as the elimination of the donut hole in the prescription drug benefit.