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On the Issues

Saving Medicare

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In this article, Joseph Antos and Mark V. Pauly warn about the impending financial crisis in Medicare and suggest a market-based solution to the problem—phasing in a sustainable credit system for Medicare recipients that allows them to choose their own health care plans. This arrangement would not only cut down on spending, but would also allow consumers to select from a variety of products and provide them far greater choice than they currently have.

Medicare is in perilous financial shape. The number of seniors receiving benefits will double over the next two decades as baby boomers head to retirement, and each new beneficiary will spend substantially more health care dollars, on average, than today's seniors. Unless we can get costs under control, Medicare will need an additional $36 trillion to stay in business over the next seventy-five years.

How can we avoid this looming crisis in Medicare's financing? Five years ago, Congress adopted a "trigger" mechanism to force action should Medicare's financial performance begin to falter. In early February, the trigger was tripped, requiring President George W. Bush to submit a plan to Congress to control costs. Congress, however, did not oblige itself to actually pass legislation—and seems decidedly uninterested in the president's suggestions.

Its reticence is understandable. Medicare is very popular. Seniors know they are getting a bargain, since subsidies pay 85 percent of the cost of their health care under the program. Younger people are footing the bill, and with three workers paying into the program for every person receiving benefits, the tax burden has been kept fairly low—so far.

That is about to change with a vengeance. Retiring boomers will outnumber new workers entering the labor market as early as 2012. By itself, this demographic shift is not a big problem. But technological advances in health care are extending life and making those extra years more worthwhile—good news that, unfortunately, comes at a price of rapidly rising spending per beneficiary, a price we might not be able to afford. If progress continues at its present pace, Medicare's burden on taxpayers will become increasingly unsustainable, both politically and economically.

Other countries have dealt with this problem by capping health care spending and rationing the demand for care through bureaucratic rules based on political value judgments. For example, Canada makes people with hip pain wait months for their operations.

There is a better way. We could restrict the growth of public spending per beneficiary, replacing Medicare's open-ended entitlement with a credit that grows at a rate that is financially sustainable. Seniors could use the credit to help pay for health plans of their own choosing and add their own money to buy more expensive plans. Plans that are fairly low cost would necessitate

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tighter rationing of new health services. Other plans might offer greater access to new services and providers for higher and more rapidly rising premiums. Competitive markets would help people deal as well as they could with limits on public resources.

Even if competition does not produce dramatic improvements in market efficiency, it has a more basic advantage: markets offer a variety of products and give consumers far greater choice than government bureaucracies.

Such competitive plans might well be more innovative than traditional Medicare in putting a package of services into a limited budget. Even if competition does not produce dramatic improvements in market efficiency, it has a more basic advantage: markets offer a variety of products and give consumers far greater choice than government bureaucracies. In a resource-constrained program, a market arrangement would allow people to choose among plans with different approaches to cost (and technology) growth, and to select the one that copes with costly but beneficial new technology in the way they most prefer.

A market arrangement would also address the problem of the "intergenerational contract"—effectively a pledge, advocates argue, from younger generations to guarantee seniors' health benefits without limit. Yet young workers are never given the choice whether to sign this pledge. The older generation made a generous promise to itself—then imposed the cost of keeping it on its children and grandchildren.

A market-based credit offers a compromise that could stave off the inevitable intergenerational strife when the "contract" can no longer be fulfilled. It would promise people nearing age sixty-five that they could continue to receive today's medical package, measured in terms of real purchasing power, but it would not guarantee more money to pay for whatever costly new technology might be introduced over time.

This sustainable credit system could be phased in, exempting current beneficiaries and those nearing age sixty-five from the limits on public spending. Younger workers would receive the credit once they became eligible for Medicare. They could supplement the credit to pay for more new technology, or they could join a health plan that adjusts its benefits over time so as to remain within the credit's budget. Poor and near-poor beneficiaries might be exempted from the spending growth limits, depending on what the social cost of curtailing their access to new technology turns out to be.

A system of sustainable credits would limit the runaway growth of Medicare spending. Compared with today's Medicare options, this limit will not make people happy. But today's generous options cannot be preserved without imposing intolerable costs on future generations. We can accept uniformly imposed, politically chosen, and bureaucratically enforced cuts in benefits—or we can give seniors the power to make the best of a difficult situation.