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Briefing Paper

Medicare Choice Plus, the Answer to the Long-Term Deficit Problem

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Executive Summary

Economists, policy analysts, and the media have given an enormous amount of attention to the long-term deficit problem in the United States. There is a continuous stream of reports and news articles showing that the United States faces a crushing long-term deficit problem. While this deficit problem is usually portrayed as being attributable to the demographics of an aging population, this description is inaccurate. Most of the projected rise in expenditures are attributable to rising health care costs for non-demographic reasons. Medicare Choice Plus is a market-oriented program that takes advantages of the opportunities offered by international trade to substantially reduce this projected path of rising government health care expenditures.

The United States is virtually alone among rich nations in experiencing a rise in health care costs, in excess of per capita GDP growth, for reasons not explained by demographics. The rapid rise in U.S. health care costs has made the United States health care system by far the most expensive in the world. Furthermore, the gap between costs in the U.S. and other countries is projected to continue to grow rapidly long into the future.

Medicare Choice Plus allows seniors to take advantage of the more efficient health care systems in other nations by giving them a voucher for their Medicare. This voucher can be used to buy into the health care programs of countries with longer life expectancies than in the United States. This rule is a quality control mechanism that ensures that seniors will only be buying into health care systems that are at least as good as the one in the United States.

This voucher will be set at a price equal to the average cost of providing care for seniors in the countries with longer life expectancies than the United States, plus half the difference between this cost, and the cost of the Medicare program in the United States. Seniors will be able to use this voucher to buy into the health care system of the country of their choice, for an amount equal to 1.2 times the average cost of senior health care in that country. They could pocket the difference between this cost and the value of the voucher.

- In the year 2006, the savings to the U.S. government for each senior who used their voucher would be $2,000. The annual savings rises to $7,700 in 2040, and reaches $23,200 in 2080 (in 2006 dollars).
- If half of all seniors opted to take advantage of the vouchers, the annual savings to the government would be nearly $100 billion a year in 2020, and nearly $600 billion a year by 2060 (in 2006 dollars).
- While the savings to seniors will vary depending on the country whose health care system they choose, over time the potential benefits will grow quite large. For example, a senior opting into the Finnish system in 2020 will have more than $4,000 a year leftover from the voucher. A couple opting into the Spanish system in 2060 will have $36,000 a year from their vouchers, which they could use to supplement their retirement income (in 2006 dollars).

- The Medicare Plus Choice system should be a boon to other rich countries that are facing financial problems paying for their own retirement programs. The 20 percent premium over country costs means that for every five U.S. retirees who enter their systems, they will be able to cover the cost of one of their own retirees.
- The Medicare Plus Choice system should also provide substantial incentives for richer developing countries, like Chile and Mexico, to improve their health care systems. Since the criterion for qualifying for the program is that people in a country have a longer life expectancy than people in the United States, countries will have an incentive to meet this target. For richer developing countries this is a goal that could be obtainable in the next two decades with a sufficient commitment of resources.

It would obviously be more rational for the United States to fix its health care system so that costs do not continue to spiral upward along the path currently projected by the government. However, if the political system proves incapable of implementing effective reforms, then it would be preferable to allow seniors to take advantage of the more efficient health care systems in other countries than to experience the budgetary disaster implied by the continued explosion of health care costs in the United States.

Introduction

The media have given a great deal of attention to the nation's long-term budget problems. Numerous news stories, columns, and editorials have warned of a future budget crisis due to the retirement of the baby boom cohort and the strains that this generation will place on Social Security and Medicare. In fact, this reporting has been largely misdirected. The impact of the retirement of the baby boom cohort will not be qualitatively different from the impact of the increases in longevity that have raised the costs of these programs ever since they were created.

Most of the projected deficits are attributable to rising health care costs. If health care costs only increased due to demographics, and otherwise rose in step with nominal GDP, approximately three quarters of the projected long-term deficit would be eliminated.[2] While this fact is not disputed among economists, many question whether the health care system can be restructured in a way to effectively contain costs. The power of interest groups opposed to any serious reform effort (e.g. the insurance industry and the pharmaceutical industry), dims the prospects for serious health care reform in the United States any time in the near future.

However, it is not necessary to reform the U.S. health care system to achieve substantial savings on health care. By taking advantage of individual choice and the benefits of international trade, Medicare Choice Plus allows individuals to escape from the inefficiencies of the U.S. health care system, securing large gains for themselves, and large savings for the government.

The basic principle of Medicare Choice Plus, is that it would allow beneficiaries of Medicare and Medicaid to use a voucher to buy into the health care system of any of the 21 countries that enjoy longer life expectancies than the United States. Since all of these countries have per capita health care costs that are far lower than those in the United States, Medicare Plus Choice can both put money in the pocket of seniors who elect to use their vouchers, and achieve substantial cost-savings for taxpayers.

The Structure of Medicare Choice Plus

The fact that there is such a large gap between per capita health care costs in the United States and other rich countries means that there is enormous potential for gains for consumers in the United States, by taking advantage of the more efficient health care systems in other countries. In 2000, the average per capita cost of health care in the 21 countries with longer life expectancies than the United States was $2230. By comparison, per capita health care costs in the United States were more than twice as high at $4540 (OECD Health Data 2003, table 9 [www.oecd.org/dataoecd/1/33/2957315.xls]).

[2] See Baker and Rosnick, 2003 "The Forty Four Trillion Dollar Deficit Scare," Center for Economic and Policy Research, [http://www.cepr.net/Deficit_scare.PDF].

Furthermore, the size of this gap is increasing rapidly. Most other rich countries have largely stabilized the rate of growth of health care costs, although the aging of the population has generally led to a rise in the share of GDP devoted to health care. The Center for Medicare and Medicaid Services projects that per person health care costs will rise to $10,700 by 2013.[3] This projection assumes that, even after accounting for demographic change, per person health care costs will continue to rise substantially more rapidly than per capita GDP over this period.

Most recent discussions of the long-term budget problem focus either explicitly or implicitly on the continuation of rapid growth in health care costs in the United States. For example, a widely publicized study showing the United States faced a long-term deficit of $44 trillion deficit assumed that the growth in health care costs, for reasons unrelated to demographics, would exceed per capita GDP growth by 1.0 percentage point annually until the year 2080.[4] At that point, annual per capita health care costs would exceed $40,000 (in 2002 dollars). The Congressional Budget Office's recent set of long-term budget projections was dependent on similar assumptions on health care costs.[5] If the United States actually experiences the sustained rise in health care costs assumed in these budget analyses, then there will be an ever-growing gap between the cost of health care in the United States and the cost in other rich countries.

Medicare Choice Plus allows seniors to take advantage of this gap, by buying into the health care systems of countries that have longer life expectancies than the United States. This is done by giving every Medicare beneficiary the option to get a voucher, the value of which will be equal to the average cost of providing health care to seniors in countries with longer life expectancies than the U.S, plus half of the gap between this cost and the cost in the United States. The U.S. government will then negotiate to have the medical systems in other countries open to seniors in the United States, at a cost equal to 1.2 times their normal cost for providing care to seniors. This ensures that, in addition to the benefits to seniors and taxpayers, the governments of other countries will also share in the gains, and therefore have an incentive to participate in Medicare Choice Plus.

The basic arithmetic on this is straightforward. The government is currently projected to pay an average of $8,500 dollars for every senior on Medicare in 2006, the first year the new prescription drug benefit will be in effect.[6] The average government payment for care for seniors in the 20 countries with longer life expectancies than the

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[3] Center for Medicare and Medicaid Services, Health Expenditure Projections 2003-2014, Table 1 [http://www.cms.hhs.gov/statistics/nhe/projections-2003/t1.asp].

[4] Jagadeesh Gokhale and Kent Smetters. 2003. *Fiscal and Generational Imbalances: New Budget Measures for New Budget Priorities*. Washington, DC: The AEI Press.

[5] Congressional Budget Office, 2003, *The Long-Term Budget Outlook*, [http://www.cbo.gov/showdoc.cfm?index=4916&sequence=0].

[6] This figure comes from taking the projected cost for Medicare, $369 billion (Congressional Budget Office, 2004, *The Budget and Economic Outlook, 2005-2014*, Table 3.1) minus offsetting receipts $54 billion (table 3-8) divided by projected population over age 65, 37.1 million (Social Security Trustees report, table V.A.2).

United States in 2006 will be approximately $4500.[7] This means that the size of the voucher would be set at $6,500, splitting the difference between the two costs. At this rate, the Medicare program would save $2,000 for every senior who opted for Medicare Choice Plus. The potential savings to the program, and the potential gains to seniors, will increase through time, as the gap between costs in the U.S. and other countries grows. Table 1 shows the potential savings through time, assuming that demographically adjusted per capita health care costs continue to grow at a rate that is 1.0 percentage point faster than the rate of per capita GDP growth.

Table 1

Savings to the U.S. Government

(in 2006 dollars)

	Cost in U.S.	Cost Elsewhere	Size of Voucher	Savings
2006	$8,500	$4,500	$6,500	$2,000
2020	$12,800	$5,700	$9,250	$3,550
2040	$23,300	$7,950	$15,620	$7,680
2060	$42,400	$11,150	$26,780	$13,390
2080	$77,200	$15,590	$46,400	$23,200

Source: OECD and author's calculations, see appendix.

The potential savings to the U.S. government are enormous, even if only a small fraction of seniors opted to take advantage of the voucher. Table 2a shows the annual saving to the federal government, if 25 percent, 50 percent, and 75 percent of seniors, respectively chose to take advantage of the vouchers and sign onto the health care system in another rich nation. As can be seen the potential savings are enormous. If just one fourth of seniors opt to take advantage of the vouchers, the annual savings would be nearly $50 billion in 2020, and nearly $300 billion by 2060. If three quarters of seniors opt to take advantage of the vouchers, then the savings would be more than $56 billion in 2006. This rises to nearly $450 billion in the year 2040. The annual savings would reach $1,700 billion in the year 2080.

[7] This calculation assumes that the ratio of the cost of providing health care for people over age 65 to the cost of providing care to the population as a whole is the same as the 2.18 ratio in the United States. (This figure is based on 1999 Medicare Current Beneficiary Survey, which places total health care spending for people over age 65 in 1999 at $9,352, [http://www.agingstats.gov/tables%202001/tables-healthcare.html]. It further assumes that the ratio of public expenditures to total expenditures in the other 20 countries is the same for the over 65 population as the population as a whole. The cost estimates for 2000 are assumed to increase by 3.5 percent annually between 2000 and 2006, 1.5 percentage points of this increase being attributed to the annual rate of per capita GDP growth and 2.0 percentage points to inflation.

Table 2a

Savings to the U.S. Government From Medicare Choice Plus
(participation rates)
(billions of 2006 dollars)

	25 percent	50 percent	75 percent
2006	$18.9	$36.7	$56.7
2020	$48.2	$96.4	$144.6
2040	$148.5	$297.1	$445.6
2060	$294.4	$588.8	$883.2
2080	$568.5	$1,136.9	$1,705.4

Source: OECD and author's calculations, see appendix.

In order to better put these savings in perspective, Table 2b shows the savings expressed as a share of GDP. Federal spending has averaged slightly less than 20 percent of GDP over the last four decades. This means that the projected savings from Medicare Choice Plus are quite substantial relative to total federal spending. In the case in which 75 percent of seniors opt to take advantage of the voucher, the savings would be equal to 3.1 percent of GDP by 2080. This amount exceeded the size of national defense budget, until the recent war-related build-up.

Table 2b

Savings to the U.S. Government From Medicare Choice Plus
(participation rates)
(shares of GDP)

	25 percent	50 percent	75 percent
2006	0.1%	0.3%	0.4%
2020	0.3%	0.6%	0.9%
2040	0.6%	1.2%	1.8%
2060	0.8%	1.6%	2.4%
2080	1.0%	2.0%	3.1%

Source: OECD and author's calculations, see appendix.

The willingness of seniors to opt into the Medicare Choice Plus program will obviously depend on their savings. These increase substantially through time. The savings also differ, depending on the health care system they buy into. Some systems provide better quality care than others. Also, the government covers a larger portion of the costs in some countries than others. Seniors would have to use money from their

vouchers to pay expenses that are not covered by the government systems – just as is the case now with the Medicare program in the United States.

Table 3 shows the savings to seniors for each country they select as their health care provider, through the year 2080. Initially, the savings are not very large. In countries with more expensive health care systems, such as Germany and Norway, seniors would be forced to pay a premium in excess of their voucher to buy into the national health care system.

However, the more rapid projected cost growth in the United States quickly increases the benefits to seniors of buying into other national systems. For example, a senior buying into the Canadian system in 2020 would be able to put $1,800 into his or her pocket that year. Buying into the Spanish system in 2020 would provide a payout of nearly $4,900. In later years, the benefits of choosing a foreign system become even larger. A couple opting into the Greek system in 2060, would have nearly $40,000 a year left over from their vouchers to help support their retirement.

Table 3

Gains to Seniors

(2006 dollars)

	2006	2020	2040	2060	2080
Greece	3700	5700	10600	19800	36700
Spain	3000	4900	9500	18200	34400
New Zealand	2500	4100	8500	16800	32400
Finland	2400	4100	8300	16600	32100
United Kingdom	1800	3300	7300	15100	30000
Netherlands	1700	3200	7100	14900	29800
Austria	1700	3100	7000	14800	29600
Italy	1600	3100	7000	14700	29500
Japan	1500	2900	6800	14400	29000
Australia	1300	2600	6300	13800	28200
Belgium	1300	2600	6300	13800	28200
Switzerland	900	2100	5600	12800	26800
France	700	1900	5300	12300	26200
Canada	600	1800	5200	12200	26000
Sweden	500	1700	5000	11900	25600
Denmark	100	1200	4300	11000	24300
Germany	-200	800	3700	10100	23100
Iceland	-500	400	3200	9400	22000
Norway	-1000	-300	2200	8000	20200
Luxembourg	-1200	-500	2000	7700	19700

Source: Author's calculations, see appendix.

The rapidly rising gains from opting into the Medicare Choice Plus system would almost certainly lead to rising enrollments through time. Presumably, intermediaries would come into existence that would help assist U.S. seniors in coping with the health care systems that they opt into. In many cases, communities of U.S. retirees may be established in these countries, so as to minimize any disruptions associated with getting health care in a foreign country.

The Seniors' Perspective

Medicare Choice Plus will allow every senior to continue to enjoy the benefits provided under the current Medicare program. However, it would also give seniors an option to buy into a more efficient health care system, and to keep much of the savings themselves. While it would be impractical for most workers to rely on a foreign health care system to provide their care, retirees may find this option more attractive. In many cases they may opt to move to the country with which they have contracted to receive care. In other cases, they may choose to remain in the United States, paying for immediate care on an out of pocket basis, but going to the country they selected for major medical procedures. The savings are likely to be sufficiently large that seniors would be able to afford a large amount of travel, and/or out of pocket expenses, and still end up ahead. (Seniors who qualify for Medicaid or other means tested health care programs would presumably be able to add these payments to their vouchers to help cover travel or out of pocket expenses.)

The Perspective of the U.S. Government

Efforts to allow seniors to contract with private insurers within the United States as an alternative to the traditional Medicare system have raised the program's costs.[8] This is understandable since private insurers add the cost of supporting another layer of bureaucracy to the costs of providing health care. By contrast, the Medicare Choice Plus system guarantees savings to the government, since it takes advantage of the more efficient health care systems already in place in other countries. (The rules would presumably include some lock-in, whereby seniors could only change their provider at infrequent intervals or with substantial penalties, in order to eliminate the problem of adverse selection either for the U.S. government or the countries providing health care services.) Every senior that opts for Medicare Choice Plus saves the system money.

[8] General Accounting Office, 2000, "Medicare + Choice: Payments Exceed Cost of Fee-for-Service Benefits, Adding Billions to Spending," August.

The Perspective of Foreign Governments

Since Medicare Choice Plus gives countries a premium equal to 20 percent of the cost of providing health care to seniors, it ensures that foreign governments gain from participating in this program as well. With this 20 percent premium, every five seniors that a country takes into its system will cover the cost of one citizen already enrolled in their government system. Many European countries are encountering serious financial problems trying to pay for their growing populations of retirees. The additional revenue they could potentially receive from Medicare Choice Plus would go far towards meeting this expense.

It is also worth noting the positive incentives that Medicare Choice Plus provides to countries to improve the quality of their national health care system. While all the countries in northern and western Europe already meet the standard of having a longer life expectancy than the United States, this is not the case with wealthier developing countries like Mexico and Chile. However, this target is not out of their reach. If these countries took steps to improve their system of health care, they could reach this target within a reasonable period of time, and thereby qualify for participation in the Medicare Choice Plus program. For this reason, an improving quality of health care in the developing world is one of the beneficial side effects of Medicare Choice Plus.

Conclusion

It is an unfortunate fact that the United States pays far more for its health care than any other country on earth, even though its health care outcomes are near the bottom of the rich countries. Current projections show these costs continuing to rise at a far faster pace than costs in other rich countries, making the disparity in spending even larger through time. The prospect of rapidly rising health care costs threatens to wreck the economy and create huge budget problems, while denying needed care to ever more people.

This situation should demonstrate the necessity of copying successful health care models in other countries, in order to bring costs under control. However, the political power of the interest groups that would be most directly affected by health care reform, makes serious reforms unlikely for the foreseeable future. Medicare Choice Plus offers seniors a way out of a broken health care system. It will provide savings to the government, additional money to support seniors in retirement, and additional revenue to the governments that provide care to participants. While it would be far more sensible to implement a serious reform of the U.S. health care system, it would be better to let seniors opt out, and save the system money, rather than letting the health care system bankrupt the economy, as is implied by current projections.

Appendix

The numbers in table 1 were derived by assuming that the rate of increase in cost per Medicare beneficiary (in 2002 dollars) would slow from the current 1.7 percentage points above annual per capita GDP growth to 1.0 percentage points above per capita GDP growth over the years 2007 to 2016. For all subsequent years, the calculations assume that costs per beneficiary increase at a rate that is 1.0 percentage point above the rate of per capita GDP growth, which is assumed to be 1.7 percent annually. Both of these assumptions follow Gokhale and Smetters, (2003).[9] The calculations assume that the per person cost of providing health care to the elderly in other countries rise at the rate of per capita GDP growth, which is assumed to be 1.7 percent a year, also. (The estimates for the 2006 cost of providing health care for the over 65 population assume that the ratio of the cost of providing care to the over 65 population to the cost of providing care to the population as a whole is the same in all other countries as it is in the United States, and that the governments of other countries pay the same percentage of the medical care expenses for the over 65 population as they do for the rest of the population.) The value of the voucher is set at the (un-weighted) average cost to the governments of the eligible nations of providing health care to the over 65 population, plus half the difference between this cost and the projected cost of Medicare in the United States.

Table 2a calculates the annual savings each to the government using alternative assumptions of take-up rates. The data for the size of the Medicare eligible population is taken from the 2003 Social Security trustees report, table V.A1. Table 2b calculates these savings as a percentage of GDP, using the assumption that per capita GDP grows at a 2.0 percent average annual rate until 2080.

Table 3 calculates the savings to individuals who choose to use the voucher, depending on the country whose health care system they buy into. The value of the voucher is calculated as is indicated in table 1. The savings for each country are based on the assumption that the cost of buying into each country's health care system is equal to 1.2 times the cost of government-provided care for the elderly in that country.

[9] Jagadeesh Gokhale and Kent Smetters. 2003. *Fiscal and Generational Imbalances: New Budget Measures for New Budget Priorities*. Washington, DC: The AEI Press.