



THE DIAGNOSIS AND TREATMENT OF MEDICARE

By Andrew J. Rettenmaier and Thomas R. Saving

FOR IMMEDIATE RELEASE: April 3, 2007

Medicare is in critical condition. Spending has risen dramatically since the program's inception, growing from about \$200 billion to \$450 billion over the last decade. Expenditures have consistently grown at twice the rate of inflation, and at times much faster, outstripping economic growth and absorbing a growing share of federal revenue. The situation will only worsen in the coming decades. As the Baby Boom generation reaches 65, Medicare's demands on federal revenues will climb even more sharply. Left unchecked, Medicare spending threatens to crowd out federal funding for education, energy, the environment, defense, and other important policy priorities.

At this critical time in the program's history, economists Andrew J. Rettenmaier and Thomas R. Saving, a public trustee of the Social Security and Medicare Trust Funds, offer an innovative remedy to Medicare's woes. Their new book, *The Diagnosis and Treatment of Medicare* (AEI Press, April 2007) calls for a rethinking of Medicare's financing, its benefit structure and its future. They dissect the existing Medicare program, evaluate a series of previously suggested remedies, and put forward their own "prepayment" solution.

The Current Medicare Program:

- Medicare's financial burden is not simply the product of an aging population. It also reflects the growing use of health services by the average Medicare beneficiary.
- Medicare has created perverse financial incentives: Doctors are paid for virtually any service they provide, while patients have almost no direct financial responsibilities and, therefore, no incentive to control costs.
- Raising taxes or increasing beneficiary premiums will not be enough to support the current program's explosive growth in costs over the long term.
- Medicare's very structure pits the interests of its patients against the younger workers who are paying the bills. Medicare's payment structure is built on transfers from taxpayers to retirees, with future generations shouldering larger costs as health spending spirals upward year after year.

Popular Reform Proposals:

In *The Diagnosis and Treatment of Medicare*, Rettenmaier and Saving use an innovative model to assess the long-term impact of popular reform proposals on Medicare's future finances. Increasing the eligibility age to match the Social Security retirement age or means-testing benefits to increase the share of the financing burden borne by the higher-income elderly would provide some fiscal relief but would not solve the long-term problem. Even extreme policies, such as eliminating first-dollar coverage, would not substantially lower the burden of the program's unfunded obligations in the long term. The authors conclude that stronger medicine is needed for Medicare.

Real Reforms to Ensure Long-Term Medicare Solvency:

Rettenmaier and Saving propose a fundamental change in the way the program is financed: prepayment for retirement health care spending. Under this plan, members of each birth cohort (i.e., individuals born during the same time period or year) would pay an annual premium throughout their pre-retirement years to secure coverage during retirement. Instead of relying on younger taxpayers to pay for retiree health benefits, as we do now, the quantity of retirement health care consumed by each birth cohort would be directly tied to the contributions made by that group during their working years.

Prepaying Medicare benefits would ultimately improve generational equity by making each age group responsible for financing the cost of its own care. Rettenmaier and Saving also support greater cost-sharing to increase cost-consciousness among consumers. That would create a health care market that is guided more by consumer choice, producing more economically efficient decisions about how much to spend on health care.

Andrew J. Rettenmaier is executive associate director of the Private Enterprise Research Center at Texas A&M University. **Thomas R. Saving** is a public trustee of the Social Security and Medicare system and a university distinguished professor of economics at Texas A&M University. They are both senior fellows at the National Center for Policy Analysis.

###