The Health Care Blog

How Should Medicare Pay for Medical Care?

By JOHN GOODMAN
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There are basically five possibilities. To compare them, let:

S = each unit of service, or a package of services

P = the price of each unit of service, or the price of a package of services

Then the government can:

1. Dictate every service it will pay for and the price it will pay for each of them (fix S and P), leaving providers to compete only on amenities, including waiting times.

2. Dictate S, but leave providers free to compete on P, say, through a system of competitive bidding.

3. Dictate P, but leave providers free to compete on what S they will provide for that price.

4. Initially fix S and P, but leave providers free to opt out, substituting different bundles of S & P as long as government's cost goes down and quality of care goes up.

5. Initially fix S and P, but allow patients to opt out, managing a portion of the funds directly and making their own purchasing decisions.

Alert readers will recognize (4) and (5) as NCPA solutions, (3) as the Rivlin-Ryan plan, and (1) as the status quo. But I'm getting ahead of the story.

Under the current system (Method 1), Medicare establishes a list of about 7,500 physician tasks it will pay, and sets the price for each of them. These prices differ, however, for every city, town, and hamlet in the land. So that in fact there are millions of prices that Medicare is administering every day.

One important drawback of this system is that it's in no one's interest to curtail spending. Every provider maximizes profit and every patient maximizes utility by exploiting the reimbursement formulas.

Method 2 essentially describes what we do under the Medicare Advantage plan program. Technically, the government requires private plans (mainly HMOs) to provide a basic set of benefits and offers a risk-adjusted (varied by expected health costs) premium for each enrollee. Plans offer additional benefits, however, amounting to Medicare, Medigap and Part D coverage all rolled into one. They are also free to vary the additional premium paid by the enrollee. In this way, they are competing for patients, at the margin, based on price.

Method 3 is the voucher idea proposed by Rep. Paul Ryan (R-WI) and former CBO Director Alice Rivlin. Yet it's not as radical as some would have you believe. It was previously proposed by a Medicare reform commission established during the Clinton administration. Basically, Medicare would offer a risk-adjusted premium payment (just as it does under Medicare Advantage) but the plans would be free to repackage the benefits they offer for that premium. They would compete to offer the most attractive S, for the P government is paying.

Method 4 is the NCPA idea of allowing providers to repackage and reprice their services, the way providers do in a normal market. This method has the advantage of allowing doctors, hospitals and other supply-side entities to profit every time they discover ways to eliminate waste and inefficiency.

Attempting to get a government agency to accept new contract terms is always going to be a poor substitute for catering to consumer needs in a market place, however. That's why Method 5 needs to be combined with Method 4 whenever possible. If seniors agree to pay for all primary care in return for a Medicare deposit to a health savings account, for example, the entire primary care sector could be revolutionized in a short amount of time.

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