

Medicare Costs Have Risen Far More than the Costs of Private Health Care

By Jeffrey H. Anderson, Ph.D., Senior Fellow, Health Care Studies

- Since 1970, Medicare's costs have risen one-third more, per patient, than the total of all health care costs in America apart from Medicare and Medicaid.
- This is true even when counting the Medicare prescription drug benefit among the costs of privately purchased care rather than among the costs of Medicare, and making other generous assumptions favoring Medicare.
- Arguments supporting a "public option" for health insurance rely on erroneous analyses of historical spending, which incorrectly conclude that Medicare has contained costs better than privately purchased health care.

As Americans contemplate a significant expansion of government's role in health care, in the form of the Medicare-like "public option" proposed by President Obama, we must consider how successful Medicare has been at controlling costs in relation to privately purchased health care.

This analysis takes all health spending in the United States and subtracts the costs of the two flagship government programs, Medicare and Medicaid. It then takes that remaining spending and compares its historical costs with Medicare's.¹ It finds that Medicare's costs have risen to a far greater extent: Since 1970, Medicare's costs, even without the Medicare prescription drug benefit, have risen 34 percent more, per patient, than the costs of all health care in America apart from Medicare and Medicaid — the vast majority of which is purchased through the private sector.²

Comparing Government-Run Health Care with Privately Purchased Care

Health care costs have skyrocketed, but they have not risen evenly. While Medicare's costs have risen 10-fold since 1970 in real (inflation-adjusted) dollars, health care costs apart from Medicare and Medicaid have only risen

four-fold.³ A large part of Medicare's cost increases, however, have resulted from increases in enrollment. In 1970, 10 percent of the U.S. population was on Medicare; last year, the figure was 15 percent.⁴ Thus, overall costs are misleading, and the fairest measure is per-patient costs.

The most logical point to start a comparison is 1970, as Medicare had then been up and running for several years. But no matter where the comparison starts, the conclusion is the same. Even without the Medicare prescription drug benefit, Medicare's per-patient costs have risen far more than the total per-patient costs of all health care in America apart from Medicare and Medicaid: 4 percent more since 2000, 14 percent more since 1990, 12 percent more since 1980, and 34 percent more since 1970.⁵

Generous Treatment of Medicare

It is important to note that this analysis gives Medicare the benefit of the doubt in four important ways.

First, it doesn't count the costs of the Medicare Part D prescription drug benefit as part of Medicare, because Part D only began in 2006.

Second, it counts all of Medicare's prescription drug costs as part of nationwide health care costs (National Health Expenditures, or NHE) aside from Medicare and Medicaid, even though a significant portion of those costs were previously covered by Medicaid. So, my methodology makes NHE apart from Medicare and Medicaid accept the full burden of Medicare's prescription drug costs. If Medicare's prescription drug costs are included among Medicare's expenditures, then Medicare's costs have increased 48 percent more, per person, than NHE apart from Medicare and Medicaid since 1970.

Third, it removes everyone who is on Medicare or Medicaid from the pool of patients receiving privately purchased care — even though, as of 2000, 32 percent of Medicare enrollees' overall health care was purchased privately.⁶ In my methodology, that entire 32 percent is counted among the costs of NHE apart from Medicare and

Medicaid, but none of its recipients are counted among the people receiving privately purchased care.⁷ Given the disproportionate growth in Medicare and Medicaid enrollment, this serves to magnify per-person cost increases for privately purchased health care. If privately purchased health care costs are divided by the whole U.S. population, rather than by the population not enrolled in Medicare or Medicaid, then Medicare's per-person costs have increased 52 percent more than per-person NHE apart from Medicare and Medicaid.⁸

Finally, this analysis doesn't address the indirect costs that Medicare imposes on the rest of society. Roughly \$88 billion in costs are shifted annually from government-run care to privately purchased care, as providers shift costs due to government's artificially low reimbursements.⁹ Medicare also imposes a significant cost on current and future taxpayers, which reduces the nation's productivity and general welfare.¹⁰

If any of these advantages were taken away, Medicare's per-beneficiary numbers would look even worse in relation to privately purchased care than they already do. Despite such advantages, Medicare's per-patient costs have risen substantially more than the per-patient costs of all health care nationwide apart from Medicare and Medicaid.

Refuting Other Claims

These findings refute the analysis of Cristina Boccuti and Marilyn Moon, and that of Jacob S. Hacker, which has received widespread attention by claiming that private health insurance has not controlled costs as effectively as Medicare has.¹¹ Those claims are deeply flawed and misleading, as they completely omit any consideration of out-of-pocket spending — a core aspect of privately purchased health care. That omission causes them to reach erroneous conclusions about the cost-effectiveness of private insurance, and leads to incorrect conclusions about Medicare's relative cost-effectiveness.

"Privately purchased health care" is not synonymous with "private insurance." Private insurance is only one part of privately purchased care; out-of-pocket payments are the other. Boccuti, Moon, and Hacker look only at the insurance segment of privately purchased health care and note that its costs have risen more, per patient, than the costs of Medicare — 44 percent more from 1970 through 2000 (Boccuti and Moon) and, overlapping somewhat, 2.7 percent more annually from 1997 through 2006 (Hacker). But they fail to note that this corresponds with a near-doubling of private insurance's share of privately purchased health care. They also fail to note that, over that same period, *Medicare's costs have more than tripled* versus private out-of-pocket costs, the other segment of privately

purchased health care.

By selecting only the private-insurance segment of privately purchased care, these analyses neglect a major shift in privately purchased health care. From 1970 to 2007, *out-of-pocket* expenditures dropped from 62 percent of the privately purchased health care market to just 26 percent. Correspondingly, *insurance* expenditures increased from 38 percent to 74 percent. These authors make no allowances for that change. That's like looking at LP or CD sales, but ignoring MP3s, and concluding that Americans are no longer as fond of music.

The most important comparison, in the context of today's high-stakes political debate over a proposed "public option," is between privately purchased health care and government-run health care. When one looks at the whole of privately purchased care, not just a select part, the results are very different from those publicized by Boccuti, Moon and Hacker. Across nearly four decades, the per-patient costs of Medicare have risen far more than the per-patient costs of privately purchased health care.¹²

Given the near-doubling of private insurance's share of private payments, its cost increases by no means prove, or even strongly suggest, that its cost-effectiveness has been comparatively poor. Boccuti, Moon, and Hacker assume that it does, a fundamental flaw in their analyses. Consider the following hypothetical example.

Assume that total per-patient cost increases for privately purchased health care did not change, but the percentage of private care paid through insurance decreased since 1970, while the percentage paid out of pocket increased. The total cost increase remains unchanged. Would the authors then have concluded that private insurance has been more cost efficient than Medicare, the necessary result under their methodology? Or would they merely have shifted their analyses and compared Medicare's costs to out-of-pocket costs?

As things stand, it is impossible to tell definitively whether private insurance has been better or worse than private out-of-pocket spending at controlling costs. Private insurance's costs have risen more, but this could simply be because private insurance is now covering a greater percentage of private care. What we can tell definitely is that private insurance and private out-of-pocket spending, in tandem, have controlled costs far better than Medicare.

Conclusion: The High Cost of Government Care

From a policy perspective, the remarkably slow growth in out-of-pocket health spending by private consumers is eye-catching. If Medicare has in fact fared particularly

poorly versus private out-of-pocket spending, then this gives even more credence to the argument, made by former U.S. Health and Human Services Secretary Mike Leavitt and others, that the real key to keeping health care costs in check is to increase consumer choice, price transparency, and cost consciousness, which is best accomplished by increasing the percentage of care paid for out of pocket. If we know how well Medicare has controlled overall costs versus privately purchased health care, then we necessarily also know this: that the better Medicare has controlled costs versus private insurance, the worse it has controlled costs versus private out-of-pocket spending. Thus, the more Boccuti, Moon, and Hacker are right that private insurance has not controlled costs as well as the whole of privately purchased care, the more Leavitt and others are right that consumers, paying out of pocket, are the best bargain shoppers and the surest pursuers of value in the American health care market. This has important policy implications, but they cannot be recognized until we look honestly at Medicare's skyrocketing costs.

By looking only at the costs of Medicare and how they have changed over time, and comparing those to the overall costs of health care apart from Medicare and Medicaid, and how those have changed over time, one can see Medicare's performance for what it truly is. For every \$3 in per-patient cost increases among (predominantly) privately purchased health care, Medicare's costs have increased more than \$4. At a moment when the country is considering a major down-payment on a new plan for government-run health care, largely on the grounds that it would allegedly save money, these facts should give one pause.

Since 1970, Medicare's costs have risen 34 percent more, per patient, than the combined costs of all health care in America apart from Medicare and Medicaid. Thirty-four percent is a lot of money when talking about hundreds of billions of dollars. If Medicare's per-patient costs had risen by only the same amount as per-patient NHE apart from Medicare and Medicaid, then, instead of costing \$468 billion last year, Medicare would have cost \$349 billion. That one-year savings of \$119 billion is almost seven times the annual budget of NASA and is more than \$1,000 per American family. Most Americans can probably think of things they'd rather do with that extra \$1,000 each year than give it to the IRS to subsidize Medicare's inefficiencies.

Much of the debate over President Obama's proposed "public option" hinges on its supporters' often repeated claim that government-run health care is more affordable than privately purchased care. But the comparison is always between government-run care, particularly

Medicare, and raw private-insurance figures, without any mention of the dramatic change in the privately purchased health care market — a market that has shifted from being dominated by out-of-pocket payments to being dominated by insurance coverage. No allowances are made for the fact that private health insurance now covers almost three-quarters of privately purchased care when it used to cover barely three-eighths.

Far more importantly, no explicit comparisons are made between Medicare and privately purchased health care as a whole. This is presumably because those who wish to expand government-run health care, in the form of a new Medicare-like "public option," don't wish to reveal that the per-patient costs of government-run health care have increased far more than the per-patient costs of privately purchased health care — and that this is true even when viewing government costs in a charitable light.

Jeffrey H. Anderson, Ph.D., is a Senior Fellow in Health Care Studies at the Pacific Research Institute. He can be reached via email at janderson@pacificresearch.org.

End Notes

1. This includes some government spending other than Medicare, such as the VA. However, this is due to data limitations. The denominator I use to calculate per-capita costs is the total U.S. population minus the Medicare and Medicaid populations. So, the appropriate numerator is total spending minus Medicare and Medicaid spending. Also, VA is only 6 percent of overall health spending.
2. Medicare's per-patient costs have risen 26.2-times, while total per-patient National Health Expenditures apart from Medicare and Medicaid have risen 19.6-times. Sources: Centers for Medicare and Medicaid Services, *National Health Expenditures by Type of Service and Source of Funds: Calendar Years 1960-2007* (Washington, DC: Centers for Medicare & Medicaid Services, December 23, 2008); Centers for Medicare & Medicaid Services, *NHE Projections 2008-18, Forecast Summary and Selected Tables* (Washington, DC: Centers for Medicare & Medicaid Services, February 24, 2009), Table 1; Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds, *2008 Annual Report of the Board of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds* (Washington, DC: Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds, March 25, 2008), pp. 32, 36; Centers for Medicare & Medicaid Services, *2008 Actuarial Report on the Financial Outlook for Medicaid* (Washington, DC: Centers for Medicare & Medicaid Services, October 17, 2008), p. 16; Carmen DeNavas-Walt, et al., *Income, Poverty, and Health Insurance Coverage in the United States: 2007* (Washington, DC: U.S. Census Bureau, August 2008), p. 61; John D. Klemm, "Medicaid Spending: A Brief History," *Health Care Financing Review* Vol. 22, No. 1 (Fall 2000), pp. 106-08; Centers for Medicare & Medicaid Services, *NHE Web Tables* (Washington, DC: Centers for Medicare & Medicaid Services, 2009), Table 1; Christie Provost and Paul Hughes, "Medicaid: 35 Years of Service," *Health Care Financing Review* Vol. 22, No. 1 (Fall 2000), p. 147; U.S. House of Representatives, Ways and Means Committee, *2004 Green Book*, WMCP: 108-6 (Washington, DC: U.S. House of Representatives, Ways and Means Committee), Appendix B.
3. That is without counting the Medicare prescription drug benefit. Costs of Medicare's sister program, Medicaid, have increased 13-fold (13 times) in real dollars.
4. The percentage of the population on Medicaid has nearly doubled, rising from 7 percent to more than 13.5 percent.

5. Medicaid's per-patient costs have risen slightly more than Medicare's, rising 35 percent more than per-patient NHE apart from Medicare and Medicaid since 1970.
6. U.S. House of Representatives, Ways and Means Committee, *2004 Green Book*, WMCP: 108-6 (Washington, DC: U.S. House of Representatives, Ways and Means Committee), p. B-4.
7. I estimate the number of dual-eligibles (people counted both as Medicare and Medicaid beneficiaries) using Provost's and Hughes's figure of 19 percent dual-eligibles in 1997 (see citation in note 1).
8. This is the method I used in a recent *Weekly Standard* article ("The Pauper Option," posted online April 15, 2009) — although, using slightly different data sets, I underestimated the advantage of (mostly) privately run health care by 2 percent.
9. Will Fox and John Pickering, *Hospital & Physician Cost Shift: Payment Level Comparison of Medicare, Medicaid, and Commercial Payers* (Seattle, WA: Milliman Inc., December 2008).
10. Jason Clemens and Adam Frey, "Understanding the Tax Implications of Single-Payer Health Care," *Health Policy Prescriptions*, Vol. 6, No. 9 (September 2008)..
11. Cristina Boccuti and Marilyn Moon, "Comparing Medicare and Private Insurers: Growth Rates in Spending Over Three Decades," *Health Affairs* Vol. 22, No. 2 (March/April 2003), p. 230; and Jacob S. Hacker, *The Case for Public Plan Choice in National Health Reform: Key to Cost Control and Quality Coverage* (Berkeley, CA: University of California, Berkeley Center on Health, Economics & Family Security, and Washington, DC: Institute for America's Future, December 16, 2008).
12. Medicare's costs have risen 222 percent more than private out-of-pocket costs.