

IN BRIEF

The Future of Private Plan Contracting in Medicare*

Since the early days of Medicare, some beneficiaries have received Medicare benefits by enrolling in private plans under contract to the Medicare program. Today, private health plan contracting occurs through the Medicare+Choice (M+C) program. At the peak of enrollment in 1999, about 7 million enrollees (18 percent of the beneficiary population) were in private plans, primarily health maintenance organizations (HMOs). But as of July 1, 2002, enrollment had declined to 5.5 million, or about 14 percent of beneficiaries. Many attribute this decline to flaws in the M+C payment methodology. Since it is likely that some form of private health plan contracting will be included in a restructured Medicare program, it is important to understand the main payment approaches that might be used to pay private health plans. This In Brief summarizes the major findings of the AARP Public Policy Institute Issue Paper, *The Future of Private Plan Contracting in Medicare*, which describes these approaches and discusses the advantages and disadvantages of each.

Key Findings

- Medicare can achieve several goals and objectives by contracting with private plans, including:
 - improving efficiency and fairness;
 - reducing government spending;
 - provide additional benefits;
 - enabling spillover between private plans and the traditional Medicare program and vice versa;
 - enhancing beneficiary choice; and
 - promoting innovation.

Current Approach

The Balanced Budget Act of 1997 (BBA) established 3 payment formulas: a “floor” or minimum amount; a guaranteed percentage increase; or a blended payment. M+C plans are paid on the basis of the formula that yields the highest payment. In spite of Congress’ intent to correct earlier problems, the M+C approach has created new concerns that have been manifested by significant plan withdrawal from Medicare and considerable beneficiary anxiety about instability in the M+C program.

* Berenson, Robert and A. Brian E. Dowd, *The Future of Private Plan Contracting in Medicare*, AARP Public Policy Institute (PPI publication 2002-12), July 2002.

Payment Approaches

The authors note that the selection of a payment approach will reflect a philosophical view of how the Medicare program should work, particularly the role of the traditional program in the presence of private contracting. Under some approaches, traditional Medicare is treated as just another health plan when setting the government's contribution; under others, the traditional program is maintained and not forced to compete with private plans directly. Notwithstanding this overarching issue, it is important to consider policy coherence in selecting a payment approach. It is possible to contemplate a situation in which mixing and matching program components of different payment approaches permits political agreement but not policy consistency.

The authors discuss three broad categories of payment systems: those that pay health plans at full risk for the cost of services; those that share risk between government and the health plans; and those that reimburse plans for their costs. Full-risk systems employ capitation and pay plans a fixed amount per enrollee. Shared-or partial-risk systems attempt to balance the incentives of capitation and fee-for-service. Cost-based systems provide no incentives for efficiency and are not found in the private sector. The following payment approaches represent these three broad systems:

- full risk, administered pricing;
- partial-risk/risk-sharing;
- competitive pricing;
- value-based purchasing;
- cost-reimbursement; and
- administrative services-only.

Conclusions

The authors conclude that there is no right way to pay private health plans. To a great extent, the payment system must conform to the goals established for Medicare restructuring in general and to the objectives for contracting with private health plan in particular. However, consensus on these goals and objectives is currently lacking. The temptation to mix and match among different approaches to achieve political consensus could be done at the expense of a consistent and coherent payment policy.