CAN A USPS-RUN HEALTH PLAN HELP SOLVE ITS FINANCIAL CRISIS?

Testimony of Walton Francis

Independent Consultant and Principal Author of
CHECKBOOK's Guide To Health Plans For Federal Employees

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Committee on Oversight and Government Reform

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Mr. Chairman, and members of the Subcommittee:

I am pleased to testify before you today concerning the current status and performance of the Federal Employees Health Benefits Program (FEHBP) as it relates to the United States Postal Service (USPS) and USPS solvency problems. I am testifying in my personal capacity, not as the principal author of *CHECKBOOK's Guide to Health Plans for Federal Employees*, and not as a consultant to the Centers for Medicare and Medicaid Services. All views expressed are my own.

Let me start by saying that I have a great deal of sympathy for the USPS, which finds itself in a predicament that is primarily the result of a (1) flawed statute that enables the Congress of the United States to micromanage what should be business decisions, of (2) bizarre accounting and budget scoring rules that fail to recognize fiscal realties, (3) of an Internet business threat whose severity few if any could have fully foreseen as recently as a decade ago, and of (4) essential reforms to the Medicare/FEHBP interface that are long overdue and that were never seriously considered by the Congress over the last decade, under the stewardship of either party or either branch of government. For these reasons alone, the Congress should give the USPS fiscal relief to the tune of billions of dollars a year.

But the problem is also one of fiscal and bargaining mistakes by the USPS, and nowhere have these mistakes been as important as in its (5) decisions on health insurance subsidies for its employees. The USPS has for decades provided unnecessary subsidies to its employees' health insurance costs and, despite some recent reductions, still pays a higher share of premiums by far than is standard among American corporations or consistent with its fiscal condition.

I will address each of these issues in turn, and then address (6) the health insurance reforms that I think the USPS and the Congress should make. In fact, I regard the current postal fiscal crisis as a wonderful opportunity to make changes that would protect and preserve the FEHBP for decades to come, to the benefit of all employees and retirees, both postal and non-postal.

Dismantling the FEHBP

The USPS proposals would massively disrupt or destroy the FEHBP, the single most successful health insurance program ever operated by the United States government. In destroying the FEHBP, the USPS would disrupt the health insurance of 8 million Americans, and breach statutory entitlement promises made to millions of Federal retirees. In a world where the House of Representatives' own Budget Resolution, voted just a few days ago, is routinely dismissed as "radical" or "ideological," these proposals certainly exceed in immediate harm anything the Congress has previously endorsed or voted for other Medicare recipients or retirees. No one, for example, has previously proposed radical reductions in the statutory retirement benefits of existing Medicare retirees. Yet the USPS proposal does just that.

It would pull out almost one fourth of current Federal employee enrollees, and a like percentage of Federal annuitant enrollees. Plans that currently enroll half or more postal employees, such as the National Association of Letter Carriers (NALC) plan, and the Rural Postmaster plan, would be decimated. It is hard to see how the FEHBP could survive with any similarity to its current design. For example, there are 18 plan options available nationally to Federal employees and retirees. Of these plans, 15 are open to all employees. If all of the postal union plans (all but one of which are open to all Federal employees) went under, the total number of national plans would drop to 11, and those open to all would drop to 8. HMOs aside, plan choices would be cut in half for almost all employees and retirees. And many HMOs would leave the program as well, as their enrollment dropped in cities and towns all over America.

The numbers of employees and retirees affected would be staggering. For example, the Mail Handlers Standard option plan enrolls about 150,000 employees and retirees. Only about 10,000 of these are postal employees. If this plan went under, all 150,000 Federal employees and retirees would be forced to change plans. Likewise, the NALC plan enrolls about 120,000 employees and retirees. About 30,000 of these are postal employees. If this plan went under about 120,000 employees and retirees would be forced to change plans. In both cases all postal annuitants over the age of 65 would be forced not only to change plans but also to leave the FEHBP.

President Obama has been criticized for promising that under Health Reform all Americans would be able to stay in their existing health plans. To whatever degree this promise was exaggerated, the USPS plan, if adopted by the Congress, would make it look like solid gold.

The FEHBP as a Model for Insurance Reform

In my scholarly book, *Putting Medicare Consumers in Charge: Lessons from the FEHBP*, I concluded that over the last 50 years the FEHBP has outperformed Medicare in cost control, in service, in benefit generosity, in fraud prevention, and in protecting enrollees from catastrophically high health care expenses.

I was not the first to reach these conclusions. Every major Medicare reform proposal of the last decade, enacted or not, has been based on the FEHBP model. In 1995 the Heritage Foundation published "The FEHBP as a Model for Medicare Reform." During the Clinton Administration the National Bipartisan Commission on the Future of Medicare, otherwise known as the "Breaux/Thomas Commission," in 1999 endorsed the FEHBP model of consumer choice among competing plans by a majority vote, just short of a super-majority vote. During the recent Bush Administration the Republican-controlled Congress enacted the Medicare Modernization Act in 2003, explicitly modeling both the Medicare Advantage program and the Medicare Prescription Drug Program (Part D) on the FEHBP. In fact, the MMA requires that in administering these programs the Centers for Medicare and Medicaid Services (CMS) use the policies and methods of the FEHBP.

All of the recent reform proposals for Medicare, including the first Ryan plan, the Ryan/Rivlin plan, the Rivlin/Domeneci plan, the Burr/Coburn plan, the Lieberman/Coburn plan, and the Ryan/Wyden plan (among others), have attempted to follow even more closely the FEHBP model under which all plans (including original Medicare plans) compete on an equal footing to attract enrollees, holding down costs through competition among plans.

The Rand/Graham/Lee/Demint plan introduced last week, which would enroll all Medicare beneficiaries in the FEHBP, would not only follow the FEHBP model, but would explicitly rely on the FEHBP plans to enroll 50 million Medicare beneficiaries in the same risk pool as Federal employees and retirees. Whatever one's view of this scheme, the USPS proposal would destroy it as an option.

In the present charged political environment, with arguments before the Supreme Court on the individual mandate even today, I hesitate to mention this, but the Obama Administration's health reform law follows the model of the FEHBP in promoting competition among health plans in a health insurance exchange. And what, one might ask, are the major differences between the FEHBP statute and the legal challenge before the Supreme Court? One answer is that unlike health reform, the FEHBP does not impose an individual mandate.

It hardly seems inappropriate to ask how, of all those insurance experts of both parties and both houses of Congress who have looked to the FEHBP as a model, only the USPS sees it as an albatross to be abolished.

Follow the Money

The USPS has no professional or historical competence in insurance design or in analysis of health insurance reform models, and probably no real desire to gain these. The USPS is clearly looking for a solution that would allow it to obtain a taxpayer subsidy in the billions of dollars. It would do so by claiming that its new plan would enable it to eliminate or vastly reduce the contributions to FEHBP reserves for retirees that it is forced to make under present law. The motives for this are perfectly clear and transparent. Indeed, in some sense the logic of the USPS proposal is impeccable. If a debt is onerous, make whatever changes are needed to write it off.

It is not my intention to analyze the actuarial or legal rationale through which the USPS seeks to reduce, most notably, the $5 billion a year it is currently required to pay to "pre-fund" its retiree health benefits. But I will make the following observations, which can readily be confirmed by the Congressional Budget Office or any fiscal expert.

Under current law, the Federal government maintains a number of trust funds, including the Federal retiree health benefits trust fund, the Medicare Part A trust fund, and the Social Security trust fund, that are intended to somehow segregate and preserve funds to meet future obligations. Under the fiction that the USPS is a true business (a principal supposedly established in the 1970 Postal Reorganization Act, and reaffirmed in the 2006 Postal Accountability and Enhancement Act), the USPS is supposed to prefund its retiree obligations on the same basis as private corporations. But the 2006 Act in particular was an exercise in science fiction. It gave the Federal government a budget windfall in the arcane "scoring" rules that govern Congressional score keeping on budget matters.

But all these trust funds are "let's pretend." You may recall the debates late in the Clinton Administration over placing the Social Security trust fund in a "lock box." The only thing more surreal than those debates was the underlying reality: all of these trust funds are EMPTY in fact if not in accounting. The money has been spent. The only things remaining are accounting pretenses. Put another way, every dollar that the USPS does not contribute to deficit reduction through charges to its patrons or reductions in employee benefits is a dollar that the taxpayers will have to borrow now and repay in the future. The issue before the Congress is not whether or how to fund real obligations with monies placed in real trust funds, but how to apportion USPS insolvency among future taxpayers, postal patrons, and postal employees.

In February, the HayGroup consulting firm presented a purportedly sound analysis of the USPS proposals whose "starting point" was the measurement of trust fund obligations prepared by the OPM Office of the Actuary. But all estimates by that Office are based on the accounting fiction that the trust funds actually exist as dedicated funds unavailable to fund the government's current account deficit. The HayGroup report on "United States Postal Service Retiree Health Benefits" made clear in its key assumption on "Funding Method" that "the funding forecast assumes the

USPS retains the PSRHBF assets” (page 2). These assets do not exist except as a legal and accounting fiction. The money has been spent.

(As an aside, the HayGroup report was dated February 10, 2012, and assumes that all annuitants over age 65 “enroll in Medicare Parts A and B with no penalty” (page 4). Meanwhile, a USPS PowerPoint presentation entitle “USPS Health Care Program,” apparently also prepared in February of 2012, says that “growing nonparticipation in Medicare increases costs for USPS and for participants” (page 3). Apparently the USPS and its consulting firm are not on the same page.)

This fiscal legerdemain then raises the obvious question: why dismantle the FEHBP to preserve accounting fictions that no responsible and informed adult believes to be true? Why not just eliminate the prepayment obligations by the stroke of a pen, and leave this valuable program to continue to provide high value for money? Is the Federal government really so incompetent that it would abolish one of its most cost-effective programs to maintain the pretense that it is fiscally responsible?

The USPS Substantive Proposals on the Merits

The USPS has changed its proposals in recent months. Originally, for example, it claimed that a major part of its savings would arise from paying new Postal employees a lower health insurance subsidy. This claim suffered from the obvious problem that the USPS won’t be hiring any consequential number of new employees for decades as it downsizes—savings zero.

Then and now the USPS claims that FEHBP plan designs are somehow obsolete and do not match “best practices” in the private sector or align “cost to value.” This naturally raises the question as to how all those Congressional leaders and experts of both parties could have been so badly fooled all these years. How is it that only the USPS has been able to detect that the FEHBP plans fail to provide health promotion and wellness benefits, and chronic condition and disease management programs? And of course the truth is that the FEHBP provides all these things and many more. It is more than passingly ironic that a USPS system facing ever more devastating competition, include parcel carriers and the Internet, fails to understand that competition among competing health plans drives down costs while improving service.

Nonetheless, the FEHBP is no longer the best model of effective competition among health plans. Medicare Advantage and Medicare Part D share that blue ribbon prize. After all, Part D has held its costs to a level roughly forty percent below that predicted by both CMS and CBO actuaries and experts, a record the FEHBP cannot match. But the FEHBP is no slouch, and has outperformed the “one size fits all” traditional Medicare for almost the entire history of both programs in controlling costs. As a point of comparison, the mis-designed TRICARE system makes even traditional Medicare look like a miracle of modern management.

The current “discussion draft” USPS proposal proudly proclaims that it will provide a reform that will “especially benefit annuitants who cover only self and spouse” (as opposed to larger families). The truth of this claim is easily tested. According to the U.S. government’s Medical Expenditure Panel Survey (MEPS), the annual cost of health care at age 55 to 65 is about $8,000 per person. So the cost of health care for a retired couple is approximately $16,000. The annual cost for an adult under age 35 is about $2,000, and for a child is about $1,500, according to MEPS. So the annual cost of a premium for a retired couple would be about $16,000 (less cost-sharing) and for a young family of four about $7,000 (less cost sharing). In other words, this wonderful reform would, other things equal, charge retired couples more than double the premium amount charged young families.

The falsity of this pipe dream about the alleged benefits of a "couples" premium has been described for decades by the OPM actuaries and by advice given through *CHECKBOOK's Guide to Health Plans for Federal Employees*. But the postal bureaucrats who designed these "reforms" are not health insurance experts and would not be expected to know such things.

Interestingly, the February 2012 USPS discussion draft, in describing the "key features" of the "proposed USPS plan" demonstrates an either unintended or deliberate decision to drastically reduce insurance benefits. This contradicts previous USPS promises that it would maintain or improve those benefits.

Under the discussion draft proposal, Blue Cross Standard option is described as charging 15 percent in network coinsurance for most services. This is false. This plan charges no coinsurance for inpatient hospital services and $20 or $30 copays for most outpatient services. The document then goes on say that the Blue Cross plan has a $5,000 out of pocket limit and no limit for prescription drugs, even though drugs are included in the plan's $5,000 OOP limit. These features are proudly contrasted with a USPS "High Option" that charges 10 percent coinsurance for all hospital stays and all physician visits, and that has an OOP limit of $7,500 for medical and drug expenses combined. If the best USPS plan is so inferior to Blue Cross Standard option, one hesitates to describe the "Middle" and "Value" USPS options. Suffice it to say that not one single FEHBP plan has benefits as poor as the "Value Option," and only one has benefits as poor as the "middle" USPS option. So the truth is revealed: in sharp contrast to earlier promises, the USPS now proposes a massive reduction in health insurance benefits to current employees in the name of modernization and value purchasing.

To its seeming credit, the USPS plan includes a consumer-driven high deductible option in its so-called "Value Option." This plan would have a $4,000 deductible. But there is something missing. Unlike all the consumer-driven plans in the FEHBP, there is no Health Savings Account or comparable reimbursable arrangement. In the FEHBP plans, this account is typically about $1,500 to $2,000 for a family. In the USPS scheme, it got left on the cutting table.

It is not an easy task to design a sensible health insurance reform, and there is an important and essentially insurmountable problem facing the USPS proposal. The FEHBP operates as a single risk pool. An agency with a disproportionate number of older and more costly enrollees has its premium costs subsidized by agencies with a disproportionate number of younger and less costly enrollees. Younger and older enrollees pay the same premiums. Experts and ethicists differ on the merits of such a system. But whatever its overall merits, it is the reality of the FEHBP and of the system the USPS proposes to leave. What do current data tell us about the problems created by a pullout? Quite a lot! The following table shows the consequences to the USPS of a pullout from the FEHBP, using 2009 data:

Age:	Under 35	35-44	45-54	55-64	Over 65	Total
Ave Cost at that age (MEPS)	$2,000	$4,000	$6,000	$8,000	$11,000	
Number of postal self-only enrollments	15,000	25,000	69,000	62,000	7,000	178,000
Total Cost (M)	$30,000	$100,000	$414,000	$496,000	$77,000	$1,117,000
Average cost per postal employee						$6,275
Number of non-postal self-only enrollments	161,000	109,000	191,000	179,000	25,000	665,000
Total Cost ($M)	$322,000	$436,000	$1,146,000	$1,432,000	$275,000	$3,611,000
Average cost per non-postal employee						$5,430

As these numbers show, the USPS has an employee pool that is substantially more costly than that of non-postal employees, simply because it is older. To provide the identical benefits and premium levels to USPS employees that nonpostal employees receive will cost about one sixth more per employee, or about one tenth of the all-employee average. Put another way, just to break even the USPS will have to reduce benefits or increase premiums by about one tenth. Considering that USPS employees number about 500,000, and that average premium costs per enrollee in the program (self-only averaged with self and family) are about $11,000, the costs of a pullout to the USPS will exceed one billion dollars annually just to maintain current levels of benefits and premiums. And over time, as the postal work forced ages further, the costs will rise sharply.

Put another way, the FEHBP is a giant insurance pool. All workers and retirees pay either a self-only or self and family premium, regardless of their age. Younger workers subsidize older workers. Retirees with Medicare subsidize all the rest, because Medicare is "primary" and pays about three fourths of health care costs (more, for the few Federal retirees who get prescription drug coverage from Medicare). Within this pool, postal employees benefit because they are older and more costly than average. Were the USPS to pull out, its premiums would increase to maintain equivalent benefits, while those of other GS and other non-postal workers would decrease.

The USPS Record in Health Insurance Cost Control

Unlike almost all other agencies, the USPS has substantial discretion over insurance benefits. While the USPS was not given the authority to override OPM in plan participation and benefit design decisions, it was given the authority to decide on premium subsidy levels.

That authority, exercised through collective bargaining, has led to multi-billion dollar spending decisions. This year the USPS pays up to 83.5 percent of plan premiums, whereas for GS and other non-postal employees the maximum payment is 75 percent of plan premiums. And the USPS pays this rate up to 80 percent of the costs of the average plan, compared to a ceiling of 72 percent for nonpostal employees and all retirees. The result of this generous contribution formula is that on average the USPS pays about $1,000 more for family premiums, and about $500 more for self-only premiums, than the rest of the government. This is a rate negotiated through collective bargaining, and in prior years the difference was even larger, but for an organization that is essentially insolvent, and has known for years that insolvency loomed, that seems rather oddly generous. Considering that about two thirds of postal workers have family policies, the net cost of this differential in 2012 exceeds $400 million. Over the last five years, the cost of this differential has been close to $3 billion.

Incidentally, according to the Kaiser Family Foundation data on employer insurance, the average percentage of premium paid by large employers is around 70 percent. So it is the USPS, not the nonpostal work force, which is out of line with modern employer practice.

What is worse, the USPS initiated what is arguably the single worst mistake in the history of the FEHBP. "Premium conversion" is a system in which the employee share of premiums is tax-sheltered (this is on top of the tax-free status of the employer share). It is routinely used by corporate America because it shifts costs to Federal taxpayers. However, it makes no sense for the Federal government itself, because it takes from one pocket to put into the other. From an insurance design standpoint, in a competitive system like the FEHBP premium conversion is a disaster, because it attenuates the already weak incentives for enrollees to choose more frugal plans. Assuming that the marginal tax rate of a postal worker is about one third on average (this includes OASDI taxes and State income tax), the 16.5 percent employee share of premium becomes more like 10 percent.

Unfortunately, the Office of Personnel Management copied this mistake several years after the USPS led the way. It is hard to estimate with any precision the effects of this policy over the years, but it is likely that it has led to average premium increases, compared to what they would otherwise have been, of close to half a percent a year, or even more. Total FEHBP costs are likely several billion dollars a year higher than they would have been without premium conversion. There is dramatic confirmation of the relatively weak current incentives in today's

FEHBP in the failure of the several consumer-driven and high deductible plans—almost all of which are excellent buys—to attract more than about one percent of total FEHBP enrollment.

What the USPS Could Do Under Current Law

As the discussion above suggests, the FEHBP could generate much larger savings than it does now. Several years ago I developed a table to show Federal agencies how much they could save if they make *CHECKBOOK's Guide to Health Plans for Federal Employees* available online to their employees, and effectively encouraged its use during Open Season. The key point is that as much as 75 percent of each enrollee's premium is paid by the employing agency, through its Salaries and Expenses account. While the table is slightly dated, and understates potential USPS savings (where the contribution rate is now as high as 83.5 percent), the potential savings are rather substantial, to say the least. As the table shows, for every employee who switches from one of the dozen highest cost plans to one of the dozen lowest cost plans, the average saving is roughly $2,000. Assuming enrollment choices are stable, which they are in the FEHBP, this is not a one time saving to the agency, but one that continues year after year.

Agency Savings Potential 2010

	Biweekly Govt Contribution		Biweekly Saving from Switch		Annual Saving from Switch	
	Self Premium	Family Premium	Self Saving	Family Saving	Self Saving	Family Saving
Govt Contribution for 12 Highest Cost Plans in DC Area (Maximum Govt Contr)	$167.61	$376.04				
Government Contribution & Savings Under 12 Lowest Cost Plans in the DC Area:						
Mail Handlers Value Option	$82.68	$197.12	$84.93	$178.92	$2,210	$4,650
Kaiser Standard	$100.49	$231.13	$67.12	$144.91	$1,750	$3,770
Aetna Healthfund HDHP	$103.51	$226.68	$64.10	$149.36	$1,670	$3,880
Mail Handlers HDHP	$107.60	$243.81	$60.01	$132.23	$1,560	$3,440
GEHA St	$111.08	$252.41	$56.53	$123.63	$1,470	$3,210
United Healthcare HDHP	$113.38	$253.29	$54.23	$122.75	$1,410	$3,190
APWU CDHP	$116.55	$262.20	$51.06	$113.84	$1,330	$2,960
GEHA HDHP	$131.82	$301.08	$35.79	$74.96	$930	$1,950
United Healthcare CDHP	$135.45	$299.84	$32.16	$76.20	$840	$1,980
Blue Cross Basic	$139.52	$326.75	$28.09	$49.29	$730	$1,280
Aetna Open Access Basic	$145.62	$340.79	$21.99	$35.25	$570	$920
Aetna Healthfund CDHP	$145.73	$347.75	$21.88	$28.29	$570	$740
Average government savings under these 12 plans:					$1,250	$2,660
Average for Self and Family Combined:				$1,960		

I haven't had time to make these calculations more precise for the USPS, or to reflect current postal employee plan enrollments, but a ballpark estimate would be that if one half of postal employees could be persuaded to switch from one of the higher cost plans (over one third are in Blue Cross Standard option, for example) to one of the lower cost plans, 250,000 employees times a USPS saving in excess of $2,000 each would bring in $500 million in savings in the first year alone. And this saving would put employees in good plans, not the stripped down versions the USPS is now proposing.

Here is a simple suggestion: The USPS could offer a two hundred dollar year-end bonus, perhaps as a Health Savings Account, to every employee who made such a switch in the next Open Season.

This is but one option under current law. There are others. For example, the USPS and the postal unions could collaborate on a premium contribution reform similar to the one I recommended in *Putting Medicare Consumers in Charge: Lessons from the FEHBP*. The basic idea is that the government contribution could be 100 of the cost of a lower benchmark, such as 70 percent of the average of all plans' total premium cost. This would actually reduce the employee share of premium for the most frugal plan choices. But it would raise premiums for those in the higher cost plans. Postal workers themselves would decide which plan to choose, from among the wide set of choices offered today (almost two dozen plan options throughout America, not just in the DC area). Over time, workers would gravitate to lower cost plans and the USPS would save a great deal of money.

The Good News About the USPS Retirement Proposal

The one good thing that I see emerging from the USPS proposal is its focus on the growing problem of Medicare/FEHBP premium and benefit coordination.

Medicare was created over 40 years ago, and the FEHBP over 50 years ago. The design of each has not significantly changed since its inception, with the major exception that Medicare has added private plan alternatives and a system of choice based on the FEHBP model in Medicare Advantage, as well as a prescription drug benefit. Original Medicare remains frozen in the time warp of vintage 1960 insurance patterns (e.g., the nonsensical bifurcation between hospital and physician costs, and the failure to use networks to control costs). The FEHBP has aged far more gracefully, with a market driven structure that readily adopts the latest and best insurance practices. But neither program has made any sensible accommodation to the existence of the other.

Absent legislative reform, OPM and the plans have struggled to create some kind of coordination. Unfortunately, the one they chose creates a major problem. All but one of the national fee-for-service plans in the FEHBP offer age-65 enrollees a seemingly wonderful benefit enhancement. The plans promise that if the enrollee has both Medicare Parts A (hospital) and B (physician), all hospital and physician care will be free—no deductibles, no coinsurance, and no copayments. Not only that, all this medical care will be free whether or not the enrollee uses preferred providers—network constraints go away. What could be wrong with this wonderful benefit enhancement? Indeed, the great majority of retirees elect to pay the Medicare Part B premium at age 65, and enroll in one of the national fee for service plans.

This wonderful coverage comes, however, at a high price. In 2012, the total premium cost for the most popular choice in combination with Medicare, Blue Cross Standard Option, will cost a retired couple over $7,500 in premium. This is a "for sure" expense, whether or not they ever see a doctor (of course, total cost is far higher, with most hidden in the government premium subsidies).

This same couple was most likely enrolled in Blue Cross until age 65, and was satisfied with its good benefits and reasonable premium. What changed upon turning age 65 that impelled them to pay an extra $2,400 a year for two Part B premiums? They do get that reduced cost sharing, and the ability to leave the network without penalty. However, *CHECKBOOK's Guide* estimates that in 2012 the net effect of joining Part B is to cost the average retired couple in Blue Cross Standard option more than $1,000, on average. The answer is that this decision is rational for that couple only because existing law is irrational.

Of greater importance to the program and to the United States Treasury, this decision is expensive. That retired couple has no incentive to be frugal in any way in making decisions about any kind of health care other than prescription drugs and dental care. Unlimited provider visits are free. The most expensive provider in the nation is free. The most discretionary surgical procedure is free. Durable medical equipment is free. Every conceivable medical test is free. Thousand dollar MRI and CAT scans are free. If an additional scan would show progress, the price is right for the second.

Based on robust research findings on the effects of cost sharing incentives, each person enrolled in a wraparound FEHBP plan and Medicare Parts A and B costs the Federal government somewhere on the order of 15 percent or more, or $1,500 or more, in unnecessary medical care utilization (for the source of this conservative estimate, see Jeff Lemieux *et al*, "Medigap Coverage and Medicare Spending: A Second Look," in *Health Affairs* Volume 27, Number 2, March/April 2008). With approximately 1.5 million Medicare enrollees (both single and couples), the Federal government loses more than $2 billion a year in increased utilization under the current system. Most of this cost falls on Medicare (which pays first) but as much as a half billion dollars a year falls on the FEHBP. And it falls disproportionately on plans like Blue Cross Standard Option, because they attract a disproportionate number of Medicare enrollees.

Meanwhile, it appears that increasing numbers of age-65 retirees are deciding not to sign up for Medicare Part B. They calculate, correctly, that they will save substantially in most years by not having to pay two sets of premiums. There are alternatives, such as suspending FEHBP enrollment, paying only one set of premiums, and enrolling in a Medicare Advantage plan. Today, all Medicare Advantage plans offer very good value (for example, they all have good catastrophic protection), and paying one premium is far better than paying two premiums. But very few even know this option exists, and even fewer choose it.

The trend of few retirees signing up for Part B will accelerate as more and more higher income retirees face the Medicare income-tested Part B premium penalty (almost all GS-15 or higher-graded retirees who are single will pay the higher income-tested premium if they enroll in Part B). Every such decision actually saves the Federal government money by reducing incentives for wasteful overutilization, but those savings accrue primarily to Medicare, not the FEHBP. The effect on the FEHBP is to raise premiums overall, and especially in those plans that disproportionately attract retirees (e.g., Blue Cross Standard Option and NALC).

FEHBP plans individually and the program as a whole would benefit if many more Medicare-eligible enrollees sign up for Part B. Most of this saving would, however, be offset by wasteful overutilization if current benefit design remains unchanged.

There is a major alternative. Instead of enriching benefits so far as to eliminate all hospital and physician cost sharing, in a decreasingly successful effort to induce Medicare participation, plans could instead directly subsidize Medicare Part B premiums. Ideally (from a government-wide and taxpayer perspective) plans would be strongly discouraged or even prohibited from improving physician and other ambulatory cost sharing, but instead encouraged to add benefits that are not covered by Medicare Parts A and B, such as better prescription drug coverage, vision care, dental care, and improved hearing aid coverage. (That the government's no-cost standalone dental plans would lose business, and that OPM's longstanding policy of discouraging dental benefits would be reversed, should be of no concern whatsoever since hundreds of millions of dollars in actual real savings to both enrollees and the taxpayer would be involved. Alternatively, the dental subsidy could be directed towards "free" enrollment in those plans.)

Viewed from a beneficiary perspective, the ideal result would be no-cost Part B coverage, no change in cost sharing for hospital, medical, and drug benefits based on Medicare coverage (that is, most benefits would be identical pre- and post-65, and modest additional benefits (such as a dental fund or premium subsidy of several hundred dollars) not available pre-Medicare. Take-up would be near 100 percent (why would anyone decline a free benefit?), and all enrollees would directly gain more than they do under the current wrap-around scheme, as well as retaining the ability to go out of network should they so choose, using the Medicare Part B benefit.

Under such a reform, there would have to be a one-time amnesty from the Medicare penalty for delayed enrollment or, better yet, Medicare would adopt the Part D innovation of allowing penalty-free late enrollment for anyone who had been enrolled in comparable or better "creditable coverage." (This last innovation would benefit Medicare in all situations where employers such as State or local governments had rich benefits post-65, as many do.)

Among the other benefits of such a reform, it would encourage retirees to remain in HMO plans, since there would no longer be an advantage for enrolling in national fee-for-service plans. As a result, the FEHBP would benefit from the superior cost control exercised by HMO plans. (At present, about one third of employees enroll in HMOs, but most older retirees migrate to the "free" care of the national plans and less than one tenth of annuitants are enrolled in HMOs.)

Such a program could and should be voluntary. Compulsion is not needed if incentives are properly aligned. Almost any version would be easy for plans to administer, as they currently serve large numbers of retirees both under and over age 65, with every conceivable combination of Medicare coverage, including even a few retirees and survivors in their 80s and 90s who have no Medicare coverage at all.

And if this change were made for the FEHBP program as a whole, the currently required USPS contribution for unfunded retiree health care costs would decrease substantially, thereby directly benefiting the solvency of the USPS without massively disrupting either the FEHBP and its 8 million enrollees and dependents, or reneging on retirement promises made in law to current postal retirees.

Conclusion

If Medicare/FEHBP benefit and premium coordination are not reformed, the FEHBP is likely to see costs surge over time. I urge the Congress to think "out of the box" in assessing the current state of the FEHBP and possible reform options like these. There is plenty of practical and analytic help to be found in the CBO, OMB, GAO, and OPM itself. I wish you success in making needed reforms to this vital program. It is not aging well, and the USPS proposal, while badly flawed, demonstrates the importance of reform for the program as a whole.

It is clear that the main goal of the USPS is to reduce its costs of financing retiree health costs, and the USPS is apparently even willing to take on the substantial financial burden of an aging and increasingly expensive work force to get that relief. But it is neither necessary nor sensible to do anything remotely so drastic as dismantling the FEHBP to achieve the savings it needs, and possibly even higher savings.

Thank you for the opportunity to testify today.

Biographical Summary

Walton Francis is a self-employed economist, expert in the analysis and evaluation of public programs and in government regulation. His education includes Master's degrees from Yale and Harvard universities. He has worked for the Office of Management and Budget, for the Office of the Secretary at the Department of Health and Human Services, and as a consultant to the Centers for Medicare and Medicaid Services on implementing the Medicare Advantage and Prescription Drug Plan programs and on reforming regulations.

He pioneered the systematic comparison of health insurance plans from a consumer perspective, as the principal author of the annual *CHECKBOOK's Guide to Health Plans for Federal Employees* (available online at www.guidetohealthplans.org). He has published articles and testified before Congress on the performance of the Federal Employees Health Benefits and Medicare programs. His 2009 book *Putting Medicare Consumers in Charge: Lessons from the FEHBP* provides an in-depth evaluation of both the FEHBP and Medicare programs, concentrating on their respective strengths and weakness and recommending reforms in each.