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Term paper for Health Economics, Econ 339

Department of Defense Health Care Spending: Is Reform Necessary?

Abstract: According to a recent Department of Defense Military Health System publication (A Roadmap for Medical Transformation (2008)), the military health system is devoted to providing high quality health services to as many as 9.2 million Department of Defense beneficiaries. In this paper I discuss the types of medical care benefit packages that are provided to Department of Defense beneficiaries and address who is eligible for these programs. I examine how these programs are funded and analyze Department of Defense health care spending figures in order to determine whether the current structure of the system is sustainable. In my analysis I address some of the proposed changes to the Defense health system.

I find that the Department of Defense is facing ever increasing health care spending which is unsustainable. While reform of the current system is necessary, the issue is extremely complex and changes to the current system might prove to be especially difficult to implement due to political pressures. Despite these issues I conclude that some reform is necessary and should be implemented in order to contain the Department of Defense's costs of providing benefits.

Keywords: Military Medical Care, Tricare, Department of Defense Health Care Spending, Military Health System

1. Introduction

The Department of Defense's Military Health System has many goals: primarily to provide health benefits for active duty military so that they may serve their country, to maintain Department of Defense medical facilities and to provide health care to other Department of Defense beneficiaries. According to the CRS Report (Military Medical Care: Questions and Answers (2008)) the MHS provides benefits in the form of Tricare to as many as 9.2 million beneficiaries. The cost of providing these services is ever increasing, and the funding that covers these expenses is coming out of the Department of Defense's budget. According to a recent Congressional Research Service report for Congress (Increases in Tricare Costs: Background and Options for Congress (2008), $42 billion will be allocated to health care spending in 2009. Analyses by many, including the Government Accountability Office and the Department of Defense suggest that the current structure of health service spending may not be sustainable. There are numerous recommendations that have been made in an attempt to reform the current system of health care spending. This reform is very controversial and there is opposition toward many of these proposals.

2. Department of Defense Health Care Expenditures

While the first priority of the Military Health System is to provide health care benefits to active duty personnel so that they may serve their country, according to data in figure 1, less than half of Tricare beneficiaries are active duty military personnel and their dependents. The remaining 58% of Tricare beneficiaries are retirees and their dependents. According to the Congressional Research Service report (Military Medical Care: Questions and Answers (2008)), the Department of Defense estimates that health care spending may reach $64 billion by 2015. These costs must

be covered through the Department of Defense's budget, and according to the Government Accountability Office (DOD's 21st Century Health Care Spending Challenges (2007)), the Department of Defense's discretionary budget is already growing more slowly than health care spending. The percentage of the Department of Defense's budget allocated to health care spending is growing very rapidly. The Congressional Research Service report for Congress (Increases in Tricare Costs: Background and Options for Congress (2008)) reports that only 4.5% of the Department of Defense's budget was spent on health care, in 1990; now the estimate for health care spending in 2015 is as high has 12% of the budget.

It is important to determine what is contributing to the rapid increase in the cost of providing health care services to beneficiaries. One factor discussed in the Congressional Research Service report for Congress (Increases in Tricare Costs: Background and Options for Congress (2008)) is that Tricare beneficiaries are more likely to utilize health care than people with civilian insurance programs. The data in this report show that Tricare beneficiaries are 44% more likely to seek outpatient care and 60% more likely to consume inpatient care. This report also addresses prescription medications as a factor in increasing costs; prescriptions are free when obtained through military pharmacies or require very low co-payments when purchased from civilian pharmacies. According to the Government Accountability Office (DOD's 21st Century Health Care Spending Challenges (2007)), some of the increase in medical spending can be attributed to the addition of Tricare for Life (a supplemental insurance plan for those eligible and enrolled in Medicare Parts A and B), medical care inflation, the growing number of retirees and dependents under age 65, and benefit enhancements. One example of this is the elimination of co-payments for those enrolled in Tricare Prime in 2000. Ringel, Hosek, Vollard and Mahnovski (2002) point out that "the elimination of copayments for civilian care provided to active duty dependents will

increase the demand for MHS-paid medical services" (p. xiv) and "reductions in copayments will increase the number of current enrollees who access any care, particularly among those who rely on civilian providers."(p. 49) As the burden of paying for health care is lifted for beneficiaries, demand and consumption of these services increase, and the Department of Defense is responsible for paying these costs. Table 1 illustrates how Tricare is structured (there are three different programs for active duty personnel and retirees under age 65). The Government Accountability Office points out in their presentation (DOD's 21st Century Health Care Spending Challenges (2007)) that the out of pocket expenditures for Tricare beneficiaries have not kept up with the out of pocket costs other public and private and have actually decreased for some Tricare beneficiaries. Figure 2 compares the out of pocket costs for Tricare beneficiaries with those of civilians and illustrates how out of synch costs are for Department of Defense beneficiaries and those who must rely on other public or private insurance plans.

3. Sustainability of Health Care Spending

Considering the large population of Department of Defense beneficiaries and the increasing cost of providing their benefits, it is important to ascertain whether this spending is sustainable. The Government Accountability Office (DOD's 21st Century Health Care Spending Challenges (2007)), states that benefits "may be unsustainable over the long-term" (p. 24). Furthermore, the Under Secretary of Defense for Personnel and Readiness, Dr. David Chu, stated that "health care accounts for approximately eight per cent of the Department of Defense budget, up from 4.5 per cent in the early 1990s. We project it will be 12 percent of the department's budget by the middle of the next decade. No one believes that is sustainable. Something will give" (Basu, 2007). Given the general consensus that the current system of escalating health care spending is unsustainable, it is necessary to consider reform.

4. Proposed Reforms to Department of Defense Health Care Spending

There have been many suggestions and proposals of changes for Department of Defense health spending. Two of the most frequently discussed options include changing the fees that retirees pay to keep Tricare benefits, and changing the way the military is compensated so that heath care benefits are not so heavily relied on.

4.1 Increasing Enrollment Fees

According to the Congressional Research Service report (Increases in Tricare Costs: Background and Options for Congress (2008)) for 2007, the Department of Defense "proposed charging, for the first time, annual enrollment fees for Tricare Standard, and also significantly increased annual enrollment fees for Tricare Prime. Annual deductibles would have also been increased." (p. 3) This report notes that these changes would not apply to active duty military personnel or their dependents or those enrolled in Tricare for Life. This proposal was not approved, and the Department of Defense is not able to enact any fee increases for the current Tricare system through September of 2009 due to defense authorization acts (p. 4). The Department of Defense continued to propose fee increases for 2009 but was unsuccessful. According to this same document, one explanation as to why these proposals continue to fail to pass in Congress may be that groups of military retirees argue against raising fees because "the requirements of military service are unique and extraordinary and that health-care premiums have been paid in service and sacrifice." (p.6)

4.2 Restructuring Compensation Packages

The Government Accountability Office presentation (DOD's 21st Century Health Care Spending Challenges (2007)) questions whether the compensation of military personnel and other

Department of Defense beneficiaries should be restructured in such a way so as not to rely so much on "non-cash and deferred benefits (e.g., health care benefits and retirement)" (p.28). Department of Defense beneficiaries are compensated with a mixture of salaries, retirement packages and Tricare benefits. The Congressional Budget Office analyzed the current compensation system and concluded that it is not the most cost-effective (Growth in Medical Spending by the Department of Defense (2003)). Given this information, the Congressional Budget Office recommends that two reforms be enacted: "In the first, military retirees are allowed to choose between coverage under Tricare for Life and cash; in the second, the families of active-duty service members are allowed to choose either Tricare's current options or a less generous plan and cash…those policies could save DOD $1.5 billion annually (in 2002 dollars) by 2020." (p. 17)

Some argue that there is no need to change the current compensation package for the military and that health care is so heavily relied on as a benefit because health care services are so valuable to those who serve in the military. Representative Ike Skelton enumerates just that: "Health care is one of the most important benefits our nation provides to our service members and their families. I believe Congress will be extremely reluctant to increase fees and make other changes that would erode health care benefits. We will look carefully at the assumptions in the health care request to ensure this budget adequately funds the health care needs of our troops," (Basu, 2007).

Approved Cost Containment Measures

Despite the setbacks to the proposed increases in fees, some measures were approved by Congress in an attempt to reduce health care costs. According to the Congressional Research

report to Congress (Increases in Tricare Costs: Background and Options for Congress (2008)), these include a "waiver of copayments for non-Medicare eligible Tricare beneficiaries for preventive services…a three-year military health risk management demonstration project to evaluate the efficacy of providing incentives to encourage healthy behaviors…a smoking cessation program…a preventive health allowance demonstration project running through December 31, 2011, in which not more than 1,500 members each of the Army, Navy, Air Force and Marine Corps annually would receive $500 if without dependents or $1,000 with dependents in order to increase the use of preventive health services…additional authority for studies and demonstration projects relating to delivery of health and medical care" (p. 5). Unfortunately, while these measures are aimed at reducing costs, the Congressional Research Service report states that the Congressional Budget Office does not believe that the Department of Defense will reduce expenditures by implementing these programs.

5. Conclusion

It is clear that the Department of Defense must reform health care spending. The issue is made more complex due to the sacrifices retirees and active duty personnel have made in serving their country. Despite this, it may be necessary for the Department of Defense to raise fees for retirees due to the rapidly increasing health care expenditures they are facing. The Department of Defense should also implement changes to the way they compensate those who serve in the military. Offering beneficiaries the option of choosing full Tricare benefits or less comprehensive packages with cash incentives is a necessary step as well and should be less difficult to implement because it allows the beneficiaries to be at least as well off if not better.

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Appendix

Tables

Table 1. Tricare Fees

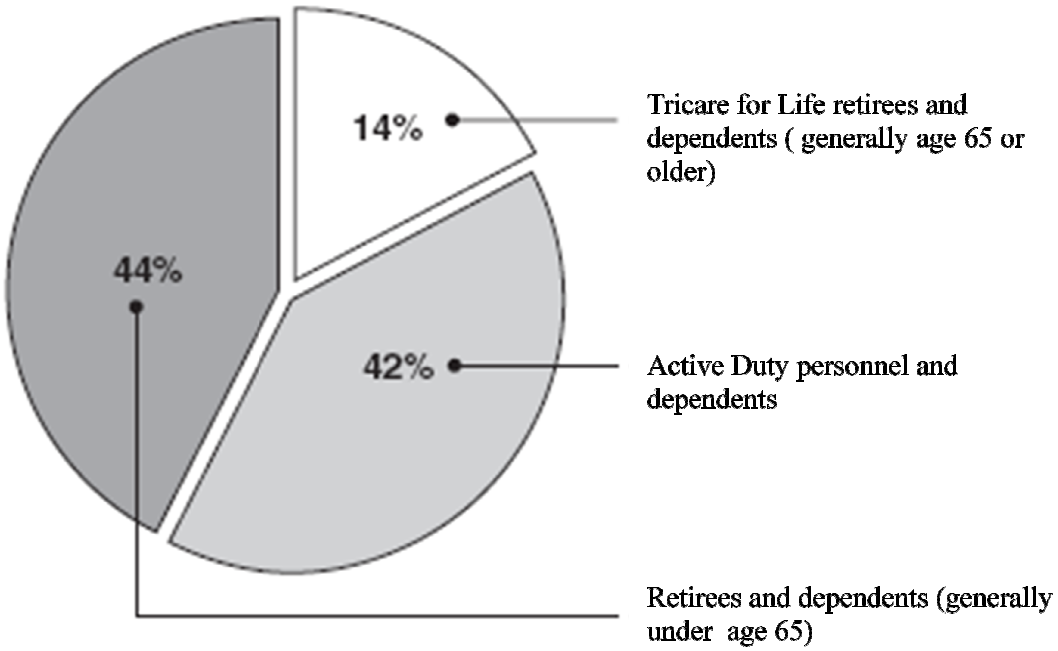
ACTIVE DUTY PERSONNEL, ELIGIBLE RESERVISTS AND DEPENDENTS			
	Prime (HMO)	**Extra (PPO)**	**Standard (Fee for Service)**
Annual Deductible	None	E-5 and above: $150/individual, $300/family Below E-5: $50/100	E-5 and above: $150/individual, $300/family Below E-5: $50/100
Annual Premium	None	None	None
Civilian Outpatient Visit Cost Share	None	15% of negotiated fee	20% of allowed charges for covered fees
Civilian Impatient Admission Cost Share	None	Greater of $25/admission or $14.35/day; No cost for separately billed professional services	Greater of $25/admission or $14.35/day; No cost for separately billed professional services
RETIREES UNDER AGE 65 AND THEIR DEPENDENTS			
	Prime (HMO)	**Extra (PPO)**	**Standard (FFS)**
Annual Deductible	None	$150/individual, $300/family	$150/individual,$300/family
Annual Premium	$230/individual, $460/ family	None	None
Civilian Outpatient Visit Cost Share	None	20% of negotiated fee	25% of allowed charges for covered services
Civilian Impatient Admission Cost Share	Greater of $25/admission or $11/day; No cost for separately billed professional services	Lesser of $250/day or 25% of negotiated fees, plus 20% of separately billed negotiated professional fees	Greater of $535/day or 25% of hospital per diem plus 25% of allowable charge for separately billed professional services

*Note: E-5 is a rank in the US Military, Rank for enlisted service personnel is E-1 to E-9

Source: *Military Medical Care: Questions and Answers,* pages 7 and 8

Figures

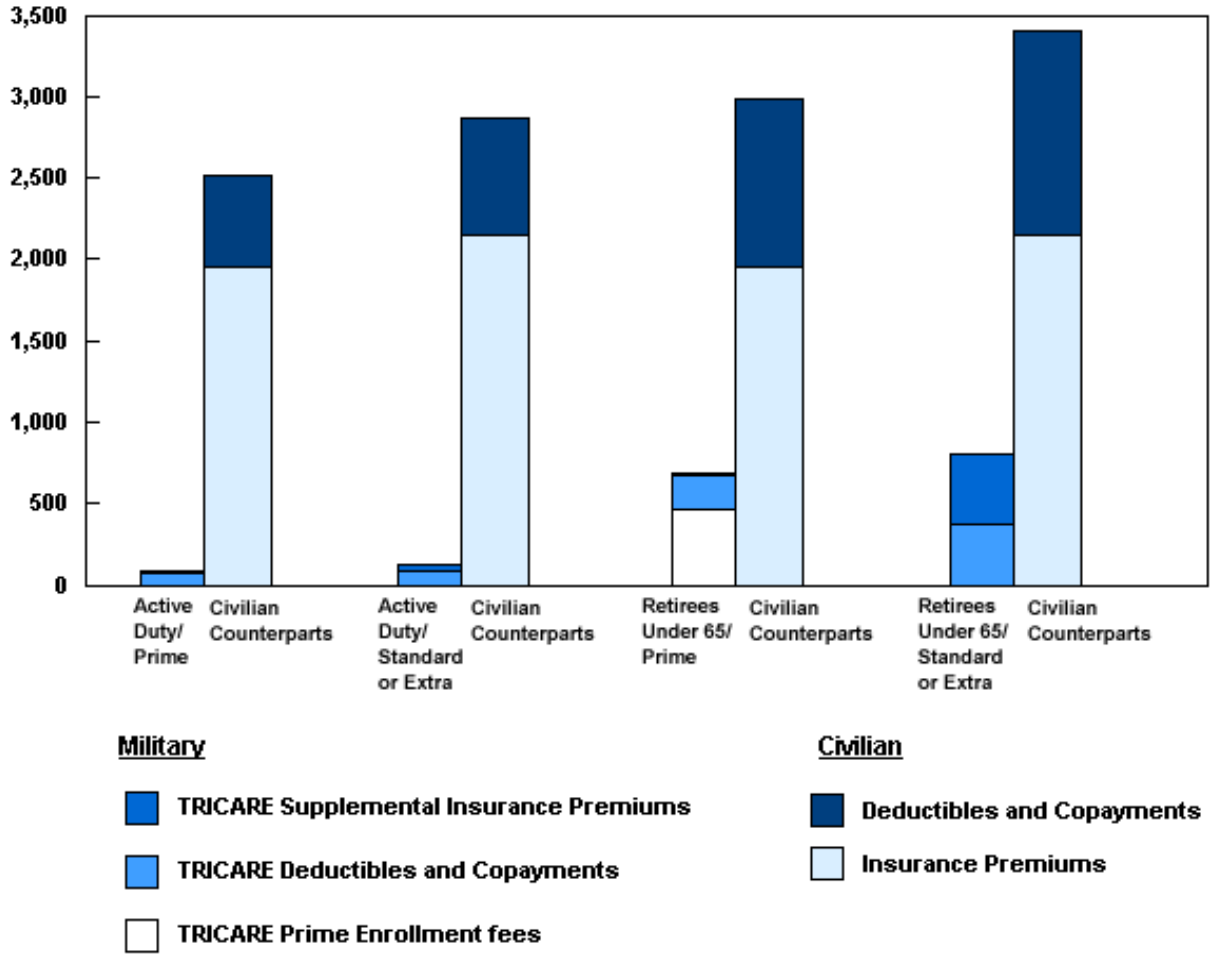
Figure 1. Tricare Beneficiaries (FY 2005)



Source: GAO-07-766G

Figure 2. Out of Pocket Costs for Military Families Using Tricare and for Their Civilian Counterparts, 2002

2002 Dollars



*Note: For military families, the designations refer to the status of the service member and the TRICARE program in which they are enrolled; for example, Active Duty/Prime refers to families of active-duty service members that are enrolled in TRICARE Prime.

Source: *Growth in Medical Spending by the Department of Defense*, CBO pg. 26