



August 17, 2007

Honorable John M. Spratt Jr.
Chairman
Committee on the Budget
U.S. House of Representatives
Washington, DC 20515

Dear Mr. Chairman:

As you requested, CBO has completed an analysis of how low bids by Medicare Advantage (MA) plans would have to be for the MA program to cost less than the fee-for-service (FFS) component of Medicare. As CBO has reported previously, the federal government spends about 12 percent more on beneficiaries in MA plans than it does on beneficiaries in FFS.¹

The government's payments to Medicare Advantage plans are derived according to a statutory formula. Plans submit bids indicating the amount for which they are willing to provide the Medicare benefit package. Those bids are compared to benchmarks determined by law: for bids below the benchmarks, 75 percent of any difference is paid to the plan to provide extra benefits to its enrollees; for bids above the benchmarks (which are rare), the entire difference is charged to the plan's enrollees.²

Thus, for example, if the benchmark for a particular area is 110 percent of average FFS costs in that area, and a plan's bid is equal to 90 percent of FFS costs, the plan would receive its bid (90 percent of FFS) plus 75 percent of the difference between its bid and the benchmark—for a total payment equal to 105 percent of FFS costs. The government would pay less than the benchmark, but still more than average FFS costs.

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1. See Statement of Peter R. Orszag, Director, Congressional Budget Office, before the House Budget Committee (June 28, 2007), p 4.
 2. In addition to the calculations described in the text, payments to MA plans are also adjusted for the health status of enrollees and other factors. Those adjustments do not materially affect the conclusions presented in this letter.

In this case, the cost to the government of the MA payments would be equal to average FFS costs if the plan’s bid was equivalent to 70 percent of FFS costs. If so, the plan would be paid its bid plus three-quarters of the difference between 70 percent and 110 percent of FFS costs—that is, another 30 percent—for a total payment equal to 100 percent of FFS costs. Therefore, in this situation, the government would realize savings only if a plan bid less than 70 percent of FFS costs.

Generalizing from this example, Medicare’s payments for beneficiaries enrolled in an MA plan would equal 100 percent of FFS costs only if the plan’s bid were below FFS costs by three times the amount by which the benchmark exceeds FFS costs. If the benchmark were 1 percent above FFS costs, the plan’s bid would have to be 3 percent below FFS costs; if the benchmark were 5 percent above FFS costs, the plan’s bid would have to be 15 percent below FFS costs, and so on.

For 2007, CBO estimates that benchmarks are 17 percent higher, on average, than projected per capita FFS expenditures nationwide. A plan in an area with the “average” benchmark (relative to FFS costs) would have to bid an amount 51 percent below FFS costs in order for the government’s payments to that plan to equal average FFS costs.

The following table provides several examples of combinations of benchmarks and bids that would produce MA payments equal to average FFS costs.

Calculation of Bids at Which Medicare Payments for Enrollees in Medicare Advantage Plans Would Equal Fee-for-Service Costs

Values expressed relative to fee-for-service (FFS) costs, per member (100 = average FFS cost)

Benchmark	Difference between Benchmark and FFS Costs	Amount Above Bid Paid to Plans for Additional Benefits ^a	Bid at Which Medicare Spending Equals 100 Percent of FFS Costs
100	0	0	100
101	1	3	97
105	5	15	85
110	10	30	70
117	17	51	49
120	20	60	40
130	30	90	10

Note: For all rows, the total payment per member equals 100, which is the sum of the bid and the cost of additional benefits.

a. In these examples, the amounts above the bid that are paid to plans for additional benefits are three times the difference between benchmark and FFS costs.

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I hope this information is helpful to you. If you wish further details on this letter, we will be pleased to provide them. The CBO staff contact is Tim Gronniger.

Sincerely,

A handwritten signature in black ink, appearing to read "Peter R. Orszag". The signature is fluid and cursive, with the first name "Peter" and last name "Orszag" clearly distinguishable.

Peter R. Orszag
Director

cc: Honorable Paul Ryan
Ranking Member

Honorable John D. Dingell
Chairman
Committee on Energy and Commerce

Honorable Joe Barton
Ranking Member

Honorable Charles B. Rangel
Chairman
Committee on Ways and Means

Honorable Jim McCrery
Ranking Republican