COPING WITH THE BUDGET CRISIS IN THE DEFENSE HEALTH PROGRAM

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Military Personnel Subcommittee

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Mr. Chairman, Mr. Snyder, it is an honor for me to appear before you and the members of this Subcommittee.

Today you have invited me to expand upon the remarks that I made before the full committee several months ago regarding the budgetary implications of inexorable growth in the cost of the defense health program and my suggestion defense health be moved off-budget.

In addressing this issue, I want to make clear that I am not a defense health expert. Nor do I feel equipped to comment upon the viability of the Department of Defense's plans to implement efficiencies in the defense health program. I know that these plans are the subject of debate among analysts far more expert than I am in this area.

I wish instead to focus on several trends in defense health policy and costs, which, I believe, will result in an ever-larger proportion of the defense budget being devoted to health, even if all DoD's recommendations are enacted into law.

I must stress that regardless of how we address this issue, we owe a great debt of gratitude to our men and women in uniform, and to the wonderful families that support them. They are prepared to make sacrifices, including the ultimate sacrifice, to defend our Nation. I want to be clear: I am addressing the issue of cost growth in the Defense Health Program not to argue for reducing benefits, but to urge us to deal with the consequences of cost growth in a manner that in no way affects the quality of care and support that the DHP provides to its recipients.

Cost growth in the Defense Health Program

As you are well aware, massive cost growth has marked the DoD's health-related accounts since the initiation of TRICARE for life and the elimination of co-pays for active duty personnel in 2001. The combined cost of those accounts has more than doubled in the past five years. It totaled $19 billon in fiscal year 2001 and amounts to nearly $42 billion in the current fiscal year (2006).

Cost growth has resulted from many factors. These include:

- elimination of co-pays for active duty personnel;
- TRICARE for life; and the creation of the Medicare-eligible Retiree Health Care Fund
- the expansion of TRICARE prime remote for service members
- and their families in fiscal year 2003
- expanded TRICARE eligibility for reserves, with a continuous

- benefit offered to those called to active duty since 9/11;
- inflation and cost growth in medical care, the latter increasing by 4% per annum on a per capita basis—the same as in the civilian sector.[1]
- Increased pharmaceutical costs. As Assistant Secretary William Winkenwerder testified a few months ago before this Subcommittee on the cost of pharmaceuticals has increased five-fold since 2001, and stands at over $5 billion annually.
- Migration of military retirees under the age of 65 from private insurance to TRICARE

The basic challenge: an expanding population eligible for TRICARE

When the 2001 National Defense Authorization Act came into force on October 1, 2001, the population of persons eligible for TRICARE for life totaled about 1.5 million. Prior to the enactment of this legislation, the Department of Defense had only paid for the costs of treating Medicare-eligible military retirees on a space-available basis in military treatment facilities. In fiscal year 2000, those costs amounted to $1.4 billion,[2] with about 342,000 actually receiving some treatment in Military Treatment Facilities (MTF) that fiscal year.

TRICARE for life meant that TRICARE became the supplemental health insurer for all Medicare eligible retirees enrolled in Medicare part b (supplemental medical insurance). It also now covered all cost-sharing for Medicare-covered services as well as cost-sharing for services not provided by Medicare. As a RAND Corporation study put it, "TRICARE for life provides Medicare-eligible retirees with one of the most comprehensive health insurance benefit packages in the United States,"[3] as well it should.

As of the last fiscal year, the number of Medicare- eligible retirees had grown by about 300,000 to 1.77 million, and it is likely to be higher this year. Moreover, as the population continues to age, the number of Medicare-eligible retirees will continue to grow, at least through the lifetime of the baby-boom generation. In the current fiscal year Medicare-eligible retirees constitute 27% of DoD health care spending. That percentage will grow by 2 per cent. to 29% in fiscal year 2011.

At the same time, the percentage of spending on beneficiaries under the age of 65 likewise is projected to grow: from about 33% today to more than 35.5% in fiscal year 2011. Many of our servicemen and women retire at ages 40 to 45 and go on to productive second careers in the private sector. Though many of these individuals may be eligible for health care insurance through their employers,

they are increasingly choosing TRICARE over private alternatives and are expected to continue to do so.

As of 2002, 72% of retirees worked for employers who offered health care coverage. Of that group, 35% enrolled in TRICARE prime and 62% sought coverage through some TRICARE option. [4] In all, 66% of all retirees under the age of 65 chose to insure their health with TRICARE.

As has been widely noted, TRICARE benefits are both less expensive to employers and employees and more comprehensive than other health care plans. As a result, employers encourage military retirees to enroll in the TRICARE program. Indeed, the Department of Defense effectively subsidizes the health care costs of a number of state governments: Alabama, North and South Carolina, Nebraska, Texas and Washington. These governments have lower health care costs because a significant part of those costs is shifted to the Department of Defense.

As a result of these developments, the percentage of retirees under 65 now enrolled in TRICARE has grown to 78%. Moreover, there is equally little doubt that, as long as TRICARE retains its competitive advantage over other plans, the number of retirees switching to TRICARE will continue to grow; it is projected to reach 87% by fiscal year 2011.

Finally, at the initiative of the Congress, we have expanded reserve eligibility for TRICARE and the Congress is considering doing so again. TRICARE reserve select (TRS) coverage, which is a premium-based healthcare plan with attractive rates, offers individual and family coverage for reserve component personnel activated for contingency operations after September 11, 2001. In addition, Guard and Reserve personnel and their families have early access to TRICARE upon notification of call-up and remain eligible for six months following active duty. While these personnel are not part of the permanently expanded TRICARE pool, they do become part of that pool if they elect TRS. These changes have been an important response to a very real problem that confronts reservists and their families when they are called up from their civilian jobs. But they do involve new costs for DoD.

DoD proposed savings will not fully control TRICARE cost growth

The Department of Defense has proposed a number of measures that would realize savings in the cost of TRICARE. These savings, even if implemented in their entirety, which in itself is an uncertain prospect, may slow program cost growth. They will not terminate cost growth, however.

To begin with, the savings are not aimed at Medicare-eligible retirees, which constitute a major driver in increasing defense health program costs. Since the size of this cohort is likely to grow, due, as I noted earlier, to increasing longevity, the cost impact of this portion of TRICARE will grow as well.

While many of the proposed savings will affect the plan as offered to retirees under the age of 65, it is unlikely that the DoD's proposals, even if implemented, will render TRICARE less attractive than other health care plans. As long as that is the case, the swelling of the under-65 TRICARE population will continue unabated, and with it, continued cost growth in the Defense Health Program.

Finally, any significant expansion of benefits to the Reserve Components will significantly reduce the Department's proposed savings, though it may help with recruiting and retention. In particular, the Congress is considering plans to expand TRICARE for all Reserves. The cost of that expansion is estimated to total $6.4 billion through fiscal year 2011 alone.

Treating TRICARE as an entitlement

TRICARE is fundamentally an entitlement. Like other entitlements, it is restricted to those who are eligible, in this case, Active and Reserve Component military personnel. Like other medical related entitlements—Medicare and Medicaid—its cost growth in recent years has been inexorable. Moreover, cost growth is unlikely to be brought under control even if the Department of Defense is able to realize every single one of its proposed savings measures. In the meantime, the defense health program will continue to consume ever larger portions of the defense budget, beyond the 7% that represents its current top-line share.

Since health care is an entitlement, there is a strong case to be made for moving significant portions of the defense health program out of the DoD budget, and treating defense health as an off-budget item, as is the case with social security today.

TRICARE is a candidate for being moved off-budget. However, if that seems too radical a move, an initial step might be to move the Medicare-eligible Retiree Health Care Fund off budget. This accrual-type fund was implemented in fiscal year 2003 to pay for health care provided to Medicare-eligible retirees, retiree family members and survivors. Until the current fiscal year, the military personnel accounts made monthly payments into the fund to cover the government's liability for the future health care cost of current service members and their families once they become eligible for Medicare (receipts from the fund cover current TRICARE costs for Medicare eligible retirees.)

The Fiscal Year National Defense Authorization Act changed the payment procedure. Section 725 of the Act provided that the Treasury make an annual payment, based on budgeted end-strengths, on behalf of the Military Departments. The fund currently costs the department of defense $10.8 billion, some 28% of the total DHP budget. Since, as I noted, there are no real savings being proposed for programs affecting Medicare-eligible retirees, the fund will continue to reflect real cost growth in health care and pharmaceuticals, as well as what can expected to be an increasing Medicare-eligible population due to greater life expectancy. The fund, therefore, is an unqualified long-term and increasingly lengthier entitlement. The FY 2005 NDAA recognized this reality.

In addition to Section 725, however, it was the sense of the Congress that any unsubscribed discretionary authority be applied to cover unbudgeted costs of Army/Marine Corps end-strength increases and of shipbuilding requirements. The Office of Management and Budget has effectively obviated this initiative by continuing to score payments to the Fund as part of DoD's discretionary budget authority. In effect, although Treasury makes the payments, the Fund remains on-budget.

Regardless of where available funds might be applied, or indeed, whether there are available funds at all, the fact remains that the Fund is clearly an entitlement, and should be treated as such in its fullest sense. If the Fund were scored off-budget, the treatment of retired military personnel over 65 would parallel the system for U.S. government civilian employees. With respect to civilians, the government's health care contribution for current employees is treated as discretionary spending, while spending for retirees is a mandatory expenditure.

I firmly believe that the entire TRICARE program for retirees should be moved out of the DoD budget. There is no obvious reason why TRICARE for retirees under 65 is any less of an entitlement than TRICARE for those over 65. But moving just the health care fund will be an important first step, which, if implemented in FY 2007, will save the Department of Defense nearly 100 billion dollars by 2015.

I do hope that the Congress will give serious consideration to this proposal, and I thank you for giving me the time to discuss it with you.

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[1] Susan Hosek, *Initiatives to Control Military Health Costs* (Santa Monica, CA: RAND, 2005), p. 2.
[2] Michael Schoenbaum et. al., *Health Benefits for Medicare Eligible Military Retirees: Rationalizing TRICARE for Life* (Santa Monica, CA: RAND, 2004), p. 2.
[3] *Ibid.*, p. ix.

[4] Hosek, *Initiatives*, p. 4.