

Setting the record straight on Medicare's overhead costs

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The traditional Medicare program allocates only 1 percent of total spending to overhead compared with 6 percent when the privatized portion of Medicare, known as Medicare Advantage, is included, according to a study in the June 2013 issue of the *Journal of Health Politics, Policy and Law*.

The 1 percent figure includes all types of non-medical spending by the Centers for [Medicare](#) and Medicaid Services plus other federal agencies, such as the IRS, that support the Medicare program, and is based on data contained in the latest report of the Medicare trustees. The 6 percent figure, on the other hand, is based on data contained in the latest National [Health Expenditure](#) Accounts (NHEA) report.

The journal article, written by Minneapolis-based researcher Kip Sullivan, finds that the gap between the two measures has been growing over the last two decades as enrollment in private Medicare plans has risen.

"The high [administrative costs](#) of the privatized portion of Medicare are no surprise," says Sullivan. "What's surprising is that the high administrative costs of the Medicare [private insurance companies](#) haven't provoked a debate about whether spending more money on insurance industry overhead is a good use of scarce [tax revenues](#)."

According to Sullivan, the low attention given to this issue is caused in part by confusion about Medicare's overhead costs.

"The confusion is due partly to the existence of two government reports," says Sullivan, "and partly to claims by critics of Medicare that the government fails to report all of Medicare's overhead costs." The paper addresses both sources of confusion.

The article explains the difference between the yardstick used by the trustees and the one used by the NHEA and concludes both are accurate. The trustees' measure counts as overhead only those administrative expenditures that support the traditional fee-for-service Medicare program, in which approximately three-fourths of all [Medicare beneficiaries](#) are enrolled. The NHEA measure takes the trustees' measure and adds to it the overhead of insurance companies that participate in Medicare Advantage and that sell stand-alone Part D drug coverage.

"The issue isn't whether one yardstick is more accurate than the other," Sullivan explains. "The issue is when it's appropriate to use one measure instead of the other."

The 1 percent figure is the one that should be used to analyze several hotly debated health reform issues, including whether to expand traditional Medicare to all Americans and whether to turn Medicare over to the insurance industry, either by expanding the Medicare Advantage program or by converting Medicare to a voucher program as Rep. Paul Ryan has proposed.

"Total spending for any type of insurer, public or private, consists of medical and administrative expenditures," explains Sullivan. "If you want to know whether Medicare would cost more or less if it were turned over to insurance companies, you first have to determine what Medicare spends on medical care and administration and you have to do the same for the health insurance industry."

The proper yardstick to use to measure Medicare's overhead in analyses of issues such as these would be the trustees' measure – 1 percent. The average overhead of the health insurance industry is approximately 20 percent, he said.

The large difference between traditional Medicare's overhead and that of the [insurance industry](#) has caused some conservative critics of Medicare to assert that the federal government is ignoring numerous administrative expenditures incurred by various federal agencies that should be attributed to Medicare.

Sullivan's paper, "How to think clearly about Medicare administrative costs: Data sources and measurement," describes this criticism as the second major source of confusion about Medicare's overhead. Sullivan's study reports that the 1 percent figure includes all appropriate administrative expenses incurred on Medicare's behalf, including those by the IRS, the Social Security Administration, and the FBI, as well as the cost of numerous pilot projects that Congress orders CMS to conduct.

Sullivan's notes that many liberals are also confused about what Medicare's overhead costs are. "With so much confusion on both sides of the political spectrum, it's fair to say a useful debate about whether to expand or contract the traditional [Medicare program](#) has yet to take place in this country," he said.

Sullivan is a lawyer and member of the Minnesota chapter of Physicians for a [National Health](#) Program, which had no role in funding the study.

More information: "How to think clearly about Medicare administrative costs: Data sources and measurement," Kip Sullivan, J.D., Journal of Health Politics, Policy and Law, Vol. 38, No. 3, June 2013. Advance version published online Feb. 15, 2013. [DOI](#)

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