



CONGRESSIONAL BUDGET OFFICE
U.S. Congress
Washington, DC 20515

Douglas W. Elmendorf, Director

February 22, 2012

Honorable Lindsey O. Graham
United States Senate
Washington, DC 20510

Dear Senator:

As you requested, CBO has analyzed whether the limitation on employer incentives to TRICARE-eligible beneficiaries (section 707 of the John Warner National Defense Authorization Act for Fiscal Year 2007, Public Law 109-364) has resulted in budgetary savings for the Department of Defense. Our analysis is detailed in the enclosure.

I hope this information is helpful. The CBO staff contact for this analysis is Matt Schmit.

Sincerely,

A handwritten signature in cursive script that reads "Douglas W. Elmendorf".

Douglas W. Elmendorf

Enclosure

cc: Honorable Carl Levin
Chairman
Committee on Armed Services

Honorable John McCain
Ranking Member

Honorable Howard P. "Buck" McKeon
Chairman
House Committee on Armed Services

Honorable Adam Smith
Ranking Member

The Budgetary Effect of Regulations Limiting the Ability of Employers to Offer Incentives to Employees to Use TRICARE

Section 707 of the John Warner National Defense Authorization Act for Fiscal Year 2007 (Public Law 109-364, 10 USC 1097c) restricts the ability of employers to offer subsidies and other incentives to their TRICARE-eligible employees to use TRICARE in place of employer-sponsored health care plans.¹ Based on the available information, CBO estimates that there is a high probability that the enactment of section 707 has resulted in budgetary savings for the Department of Defense (DoD) and that the expected value of those savings is about \$55 million per year (in 2010 dollars).² However, because of certain effects on federal revenues, the expected value of the net savings to the federal government as a whole is less: about \$30 million per year.

The savings owing to the enactment of section 707 depend to a large extent on whether beneficiaries who previously took advantage of the employer incentives continued to use TRICARE even after the implementation of that section (which often results in added costs to the government as some beneficiaries move from TRICARE Standard to TRICARE Prime) or switched to a non-DoD health care option provided by their employers (which results in savings for the government). If the growth in out-of-pocket expenses arising under employer-sponsored health care plans continues to outpace those under TRICARE by significant margins, more retirees are likely to leave employer-sponsored care and enroll in TRICARE, which will probably reduce the savings attributable to section 707. However, the path of out-of-pocket expenses under TRICARE will depend to a large extent on future decisions about the administration of that program.

Background

Retirees of the Uniformed Services often have several options available to them to cover at least some of their health care costs. As military retirees, they and their family members are eligible to use the TRICARE health benefit. They can also utilize the Veterans Health Administration and in some cases Medicare and Medicaid. In addition, because military personnel are eligible to retire after they have accumulated 20 years of service, many retirees are young enough to work in the private sector after their military

¹ The military's health care program, TRICARE, comprises nine health plans that cover uniformed servicemembers, retirees, and their dependents in the United States and abroad. Two of the most commonly used plans are TRICARE Prime—a managed care option, and TRICARE Standard—a fee-for-service option. For beneficiaries not eligible for Medicare, the TRICARE programs are funded through annual appropriations to the defense health program.

² All figures in this analysis are expressed in nominal 2010 dollars, which is the most recent year for which complete TRICARE cost data are available. Annual savings for years before or after 2010 will vary because of trends in per capita health spending.

service has concluded and thereby gain access to employer-sponsored health care benefits. A 2007 survey indicates that over 75 percent of military retirees under the age of 65 had access to a civilian health care plan through an employer or other professional association.³ Nonetheless, TRICARE remains a popular option among working-age military retirees, with a participation rate of about 75 percent.⁴

Because of increasing health care costs, employers have been actively seeking ways to lower their expenses for employee health care benefits. One approach that some employers have taken is to provide incentives to military retirees to discontinue their enrollment with the employer's group health plan and instead utilize their TRICARE health benefit. Before section 707 was implemented, this practice occasionally took the form of direct cash payments to employees. More often, employers offered subsidized TRICARE supplements. Such supplements are widely used by military retirees (they are usually offered through nonprofit servicemember organizations) and act as wrap-around coverage for the TRICARE Standard fee-for-service plan. The supplement usually pays the beneficiaries' out-of-pocket costs, such as coinsurance, or charges from health care providers that exceed the amount TRICARE will cover. This arrangement is attractive to both employers and employees; premiums for the supplements cost employers a fraction of premiums for the regular group health plans, while employees are able to utilize the flexibility of the TRICARE fee-for-service option with little or no out-of-pocket costs.⁵

CBO estimates that somewhere between 45,000 and 70,000 working-age military retirees accepted incentives prior to implementation of section 707 to use their TRICARE benefit (as much as 5 percent of the total population of working-age military retirees), with the vast majority of those incentives being in the form of employer-subsidized TRICARE supplements.

The final rule implementing section 707 was issued on April 9, 2010. It prohibits employers from providing incentives specifically targeted to TRICARE beneficiaries. However, it does not prohibit all incentives to discontinue enrollment with an employer's plan, as long as the same incentive is offered to all employees whether or not they are eligible for TRICARE. For instance, the rule permits employers to offer cash payments to

³ Louis T. Mariano and others, *Civilian Health Insurance Options of Military Retirees: Findings from a Pilot Survey* (report submitted by the RAND Corporation to the Office of the Secretary of Defense, 2007).

⁴ Department of Defense, TRICARE Management Activity, *Evaluation of the TRICARE Program: Fiscal Year 2011 report to Congress*, (February 2011), p. 77.

⁵ TRICARE Prime—the managed care option—has the lowest out-of-pocket costs of the TRICARE plans available to working-age retirees. As such, it is the most popular plan among TRICARE beneficiaries. However, because some beneficiaries do not like the restrictions that come with a managed care plan and because Prime is not available in some parts of the country, some TRICARE-eligible beneficiaries prefer to use TRICARE Standard—the fee-for-service option. TRICARE Standard offers beneficiaries more options with regard to health providers, but it has higher out-of-pocket costs.

all employees (whether they are TRICARE-eligible or not) to purchase their own health care or health insurance. Separately, the rule prohibits employers from subsidizing TRICARE supplements for its employees, but it does allow employers to offer TRICARE supplements through their group health plans as long as the employees pay the full cost of the premiums. Some employees prefer to purchase supplements through their employers because it allows them to do so through pre-tax payroll deduction.⁶

For those people who have chosen to stop using TRICARE and instead enroll in an employer-provided group health plan, their health care expenses have shifted from DoD to the private sector. As discussed later in this report, we estimate that the government loses some tax revenue when beneficiaries elect to use non-government health care plans through their employers. However, that loss in revenue is not enough to fully offset the savings to the government from the discontinued use of TRICARE by those beneficiaries. Thus, the government saves money because of the change in these people's behavior.

At the same time, some people have chosen to continue using TRICARE even without the employer-subsidized supplements or other incentives. When beneficiaries use a TRICARE supplement, it is almost always used with TRICARE Standard (the fee-for-service option of the TRICARE benefit). However, with employers no longer subsidizing the supplements for TRICARE Standard, it is likely that many working-age military retirees have stopped using Standard and have instead enrolled in TRICARE Prime (the managed care option of the TRICARE benefit) because it has very low out-of-pocket costs. However, the average cost to the federal government for TRICARE Prime is at least 15 percent higher than it is for TRICARE Standard. Therefore, the change in behavior by these people probably raises the government's costs.

CBO's Analysis of the Budgetary Impact of Section 707

Because little data are available about the population affected by section 707, estimating its budgetary effects is difficult. CBO does not know how many TRICARE beneficiaries were offered incentives or subsidies by their employers to use TRICARE prior to the enactment of section 707. Furthermore, it is not clear which health care plans those people have chosen to use since the incentives and subsidies were restricted.

Even estimating the differences in cost between TRICARE Prime and Standard is difficult. Apart from the different cost-sharing arrangements of those two options, the difference in cost to DoD is affected by different average household sizes and the relative health status of the populations choosing each option. Also, studies have shown that those with higher out-of-pocket costs generally use fewer health care services than those with little or no out-of-pocket costs. This might lead one to conclude that those who use

⁶ For specifics about the final rule, see Department of Defense, "TRICARE; Relationship Between the TRICARE Program and Employer-Sponsored Group Health Coverage," Federal Register, vol. 75, no. 68 (April 9, 2010), pp. 18051-18055. This has been codified at 32 C.F.R. 199.8(d)(6).

TRICARE Standard will use fewer health services than those who use TRICARE Prime. However, it is not clear whether beneficiaries who use Standard with a supplement, and therefore have smaller out-of-pocket costs, experience those same, lower usage rates. In any event, operating TRICARE Standard will almost always be less expensive for DoD because there is additional cost sharing borne by either the beneficiaries or a supplemental provider.

CBO created a model of the decisions of military retirees to simulate a wide range of possible outcomes. CBO used the available information to create ranges of the most likely values for each of the key estimating assumptions. The agency then used simulation software to generate alternative values for each of those assumptions and to estimate whether section 707 created costs or savings for the federal government given those assumptions. Among the key estimating assumptions are the following:

- The population of beneficiaries who received employer-subsidized TRICARE supplements or other incentives prior to the enactment of section 707 was somewhere between 45,000 and 70,000. That range is based on information from the insurance industry on the number of employees who received TRICARE supplements through their employers and on surveys of military retirees.
- Between 10 percent and 37 percent of that population chose to stop using TRICARE after section 707 was implemented and now use private-sector health care options provided through their employers or other non-government sources. That range is based on information from state governments who previously offered TRICARE supplements (covering about 7,500 employees), as well as surveys of military retirees.
- Between 28 percent and 48 percent of that population continued to use TRICARE Standard after section 707 was implemented, either without a supplement or with a supplement that retirees purchased on their own. That range is based on information from the insurance industry and the current proportion of TRICARE beneficiaries who choose to rely on Standard.
- CBO assumes that the retirees in that population who chose not to use a private-sector health care option or to continue to use TRICARE Standard have instead switched to enroll in TRICARE Prime. Based on the distributions discussed above, this means that anywhere from 15 percent to 62 percent of those who used employer-sponsored TRICARE Standard supplements prior to the enactment of section 707 are now enrolled in TRICARE Prime.

- CBO estimates that the average cost to DoD for a family enrolled in TRICARE Prime is between \$11,800 and \$13,800 (in 2010 dollars), based on information from DoD. The average cost for those retirees who enroll themselves but not their families is less.
- CBO estimates that the average cost to DoD of persons who use TRICARE Standard are about 70 percent to 85 percent of the cost of equivalent persons who use TRICARE Prime, based on information from DoD.

CBO used the above inputs to create 1,000 different simulations. CBO used those simulations for two types of analysis: one excluding effects on federal revenues and another including those effects. In the analysis excluding revenue effects, about 90 percent of the outcomes from those simulations indicate that section 707 has resulted in savings for DoD, and about 10 percent imply that section 707 has increased DoD's costs. The range of possible outcomes is admittedly large. Based on the information available, CBO estimates that almost all of the possible outcomes for DoD lie between savings of \$140 million per year and costs of \$20 million per year, with an expected outcome of about \$55 million in savings per year (in 2010 dollars).⁷

The net savings to the federal government from section 707 have been smaller than the savings to DoD because of the effects of that section on federal revenues. As discussed above, section 707 has led some people who previously relied on the TRICARE health benefit to shift to employer-sponsored group health plans. Because total compensation costs are determined by market forces, wages and other forms of compensation are assumed to decline by roughly the amounts of any increases in employers' health insurance costs. Employer and employee expenditures on health insurance premiums are generally nontaxable, so a shift in compensation from wages and salaries to additional health benefits results in lower revenue for the federal government. Based on information from the staff of the Joint Committee on Taxation, we estimate that the loss of revenue from enactment of section 707 has been between \$5 million and \$45 million per year, with an expected loss of revenue of about \$25 million per year.

With revenue effects included, about 85 percent of CBO's simulations show that section 707 has resulted in savings for the federal government. When combined with the estimate of expected savings to the Department of Defense, CBO estimates that implementing section 707 has saved the federal government, on net, about \$30 million per year (in 2010 dollars; see table below).

⁷ This range includes 95 percent of the simulated outcomes (it does not include the highest 2.5 percent or the lowest 2.5 percent of outcomes). Thus, nearly all possible outcomes fall within the estimated range of -\$140 million to +\$20 million per year, and given that range, most of the possible outcomes indicate net savings.

Simulated Effects on the Federal Budget of Section 707 of the John Warner National Defense Authorization Act for Fiscal Year 2007

	Simulated Range of Annual Savings (-) or Costs (+)	Percentage of Outcomes That Result in Annual Savings	Expected Annual Savings (-)
Without Revenue Effects	-\$140 million to +\$20 million	90 percent	-\$55 million
Including Revenue Effects	-\$95 million to +\$25 million	85 percent	-\$30 million

Sources: Congressional Budget Office and staff of the Joint Committee on Taxation.

Note: Figures are in 2010 dollars.

CBO's estimates are very sensitive to changes in some of the assumptions discussed above. As one might expect, the results are especially sensitive to the percentage of beneficiaries who chose to use their employer-sponsored health insurance after TRICARE incentives were restricted, because it is this decision that results in savings for the federal government. If the percentage of those who have chosen to use their employer health care benefits instead of TRICARE is on the low end of the distribution discussed above (15 percent or less), then section 707 has probably resulted in higher costs for DoD and for the government as a whole.

Over time, the TRICARE plans have become increasingly attractive to retirees, as the out-of-pocket costs of most private-sector health insurance have increased significantly relative to those of TRICARE. That trend has resulted in a steadily increasing share of military retirees choosing to participate in TRICARE, and should that pattern continue, the likelihood that section 707 creates additional costs for DoD will increase over time. For instance, if premiums for employer-sponsored health insurance plans continue to outpace the growth in out-of-pocket costs for TRICARE, then those retirees who switched to employer health care plans after section 707 was implemented might eventually switch back to TRICARE, and most of them would probably choose TRICARE Prime, which is more expensive for DoD under current law and existing policies. However, future out-of-pocket costs in the TRICARE program will depend to a large extent on future decisions about the administration of the program. The migration to TRICARE could decrease if out-of-pocket costs for TRICARE were raised or if retirees perceived a lack of availability of TRICARE network providers.