The Future of Medicare

Testimony before the United States Senate
Committee on Finance

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June 23, 2011

*The views expressed herein are my own and do not represent the position of the American Action Forum. I thank Nathan Barton, Emily Egan, Hanna Gregg, Carey Lafferty, Michael Ramlet, and Matt Thoman for their assistance.

Chairman Baucus, Ranking Member Hatch and Members of the committee, thank you for the privilege of appearing today. In this written statement, I hope to make the following points:

- Medicare must be reformed. The *status quo* is dangerous to the fiscal health of the federal government, the U.S. economy, and especially Medicare beneficiaries.

- Medicare is at the heart of the debt explosion that dominates the federal budget outlook.

- The federal debt explosion represents a severe economic risk that threatens national security and our future economic and job growth in the United States.

- Under current law, Medicare providers are likely to depart the market reducing access for beneficiaries. If reimbursement rates fall as in Medicaid, we will see the same kind of dramatic health consequences.

- The Independent Payment Advisory Board is a dramatic policy error that will exacerbate reimbursement problems and stifle innovation.

Let me discuss each in turn.

1. The status quo is dangerous because Medicare contributes greatly to the fiscal problems facing the Federal government.

Medicare as we know it is financially unsustainable. The reality is that the combination of payroll taxes and premiums do not come close to covering the outlays of the program. As shown in Table 1, in 2010 Medicare required nearly $280 billion in general revenue transfers to meet its cash outlays of $523 billion. As program costs escalate, the shortfalls will continue to grow and reach a projected cash-flow deficit of over $600 billion in 2020.

These shortfalls are at the heart of past deficit and projected future debt accumulation. As shown in Table 2, between 1996 and 2010, cumulative Medicare cash-flow deficits totaled just over $2 trillion, or 22 percent of the federal debt in the hands of the public. Including the interest cost on those Medicare deficits means that the program is responsible for 23 percent of the total debt accumulation to date.

Going forward, the situation is even worse. By 2020, the cumulative cash-flow deficits of 6.2 trillion will constitute 35 percent of the debt accumulation. Again,

appropriately attributing the program its share of the interest costs raises this to 37 percent.

Viewed in isolation, Medicare is a fiscal nightmare that must change course. When combined with other budgetary stresses, it contributes to a dangerous fiscal future for the United States.

2. The status quo is dangerous because the federal debt explosion represents a severe economic risk that threatens economic and job growth in the United States.

The federal government faces enormous budgetary difficulties, largely due to long-term pension, health, and other spending promises coupled with recent programmatic expansions. The core, long-term issue has been outlined in successive versions of the Congressional Budget Office's (CBO's) *Long-Term Budget Outlook*.[1] In broad terms, over the next 30 years, the inexorable dynamics of current law will raise federal outlays from an historic norm of about 20 percent of Gross Domestic Product (GDP) to anywhere from 30 to 40 percent of GDP.[2]

This depiction of the federal budgetary future and its diagnosis and prescription has all remained unchanged for at least a decade. Despite this, action (in the right direction) has yet to be seen.

In the past several years, the outlook has worsened significantly.

Over the next ten years, according to the Congressional Budget Office's (CBO's) analysis of the President's Budgetary Proposals for Fiscal Year 2012, the deficit will never fall below $740 billion.[3] Ten years from now, in 2021, the deficit will be nearly 5 percent of GDP, roughly $1.15 trillion, of which over $900 billion will be devoted to servicing debt on previous borrowing.

As a result of the spending binge, in 2021 public debt will have more than doubled from its 2008 level to 90 percent of GDP and will continue its upward trajectory.[4]

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[1] Congressional Budget Office. 2011. *The Long-Term Budget Outlook*. Pub. No. 4277. http://cbo.gov/ftpdocs/122xx/doc12212/06-21-Long-Term_Budget_Outlook.pdf
[2] Congressional Budget Office. 2011. *The Long-Term Budget Outlook*. Pub. No. 4277. http://cbo.gov/ftpdocs/122xx/doc12212/06-21-Long-Term_Budget_Outlook.pdf
[3] Congressional Budget Office. 2011. *An Analysis of the President's Budgetary Proposals for Fiscal Year 2012.* Pub. No. 4258. http://www.cbo.gov/ftpdocs/121xx/doc12130/04-15-AnalysisPresidentsBudget.pdf
[4] Congressional Budget Office. 2011. *An Analysis of the President's Budgetary Proposals for Fiscal Year 2012.* Pub. No. 4258. http://www.cbo.gov/ftpdocs/121xx/doc12130/04-15-AnalysisPresidentsBudget.pdf

A United States fiscal crisis is now a threatening reality. It wasn't always so, even though – as noted above – the Congressional Budget Office has long published a pessimistic *Long-Term Budget Outlook*. Despite these gloomy forecasts, nobody seemed to care. Bond markets were quiescent. Voters were indifferent. And politicians were positively in denial that the "spend now, worry later" era would ever end.

Those days have passed. Now Greece, Portugal, Spain, Ireland, and even Britain are under the scrutiny of skeptical financial markets. And there are signs that the U.S. is next, as each of the major rating agencies have publicized heightened scrutiny of the United States. What happened?

First, the U.S. frittered away its lead time. It was widely recognized that the crunch would only arrive when the baby boomers began to retire. Guess what? The very first official baby boomer already chose to retire early at age 62, and the number of retirees will rise as the years progress. Crunch time has arrived and nothing was done in the interim to solve the basic spending problem.

Second, the events of the financial crisis and recession used up the federal government's cushion. In 2008, debt outstanding was only 40 percent of GDP. Already it is over 60 percent and rising rapidly.

Third, active steps continue to make the problem worse. The Affordable Care Act "reform" adds two new entitlement programs for insurance subsidies and long-term care insurance without fixing the existing problems in Social Security, Medicare, and Medicaid.

Financial markets no longer can comfort themselves with the fact that the United States has time and flexibility to get its fiscal act together. Time passed, wiggle room vanished, and the only actions taken thus far have made matters worse.

As noted above, in 2020 public debt will have more than doubled from its 2008 level to 90 percent of GDP and will continue its upward trajectory. Traditionally, a debt-to-GDP ratio of 90 percent or more is associated with the risk of a sovereign debt crisis.

Perhaps even more troubling, much of this borrowing comes from international lending sources, including sovereign lenders like China that do not share our core values.

For Main Street America, the "bad news" version of the fiscal crisis would occur when international lenders revolt over the outlook for debt and cut off U.S. access to international credit. In an eerie reprise of the recent financial crisis, the credit freeze would drag down business activity and household spending. The resulting deep recession would be exacerbated by the inability of the federal government's

automatic stabilizers – unemployment insurance, lower taxes, etc. – to operate freely.

Worse, the crisis would arrive without the U.S. having fixed the fundamental problems. Getting spending under control in a crisis will be much more painful than a thoughtful, pro-active approach. In a crisis, there will be a greater pressure to resort to damaging tax increases. The upshot will be a threat to the ability of the United States to bequeath to future generations a standard of living greater than experienced at the present.

Future generations will find their freedoms diminished as well. The ability of the United States to project its values around the globe is fundamentally dependent upon its large, robust economy. Its diminished state will have security repercussions, as will the need to negotiate with less-than-friendly international lenders.

Some will argue that it is unrealistic to anticipate a cataclysmic financial market upheaval for the United States. Perhaps so. But an alternative future that simply skirts the major crisis would likely entail piecemeal revenue increases and spending cuts – just enough to keep an explosion from occurring. Under this "good news" version, the debt would continue to edge northward – perhaps at times slowed by modest and ineffectual "reforms" – and borrowing costs in the United States would remain elevated.

Profitable innovation and investment will flow elsewhere in the global economy. As U.S. productivity growth suffers, wage growth stagnates, and standards of living stall. With little economic advancement prior to tax, and a very large tax burden from the debt, the next generation will inherit a standard of living inferior to that bequeathed to this one.

3. The status quo is dangerous because Medicare will increasingly fail to provide access to quality care for beneficiaries.

Medicare coverage no longer guarantees access to care. Increasingly seniors enrolled in the Medicare program face barriers to accessing primary care physicians as well as medical and surgical specialists.

The physician access problem stems from Medicare's below-cost reimbursement rates and the uncertainty surrounding the Medicare sustainable growth rate (SGR) formula for physician payments. If the SGR were permitted to go into effect in 2012, physician services would face a reduction in payment of 29.4 percent.[5]

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[5] Congressional Budget Office. *Medicare's Payment to Physicians: The Budgetary Impact of Alternative Policies*. June 16, 2011.
http://cbo.gov/ftpdocs/122xx/doc12240/SGR_Menu_2011.pdf

While there is bipartisan agreement that the SGR formula needs to be fixed, the Patient Protection and Affordable Care Act (PPACA) failed to reset or restructure the fee schedule. As a result physicians are now faced with difficult decisions regarding whether to accept new Medicare patients or leave the Medicare market altogether.

In June 2010 Congress failed to pass a timely update to the SGR, and physicians were forced to begin making Medicare practice decisions. Table 3 shows the impact on physician access for Medicare enrollees as a result of the uncertainty created by the June 1, 2010 Medicare Part B payment reduction of 21.3 percent, which was later reversed by Congress. During the delayed SGR update, 11.8 percent of physicians stopped accepting new Medicare patients, 29.5 percent reduced the number of appointments for new Medicare patients, 15.5 percent reduced the number of appointments for current Medicare patients, and 1.1 percent of physicians decided to stop treating Medicare patients altogether.[6]

Recognizing the increased payment uncertainty caused by Congress' failure to enact a permanent SGR fix in 2010, physician practices have started to reshape their practice patterns. Moving forward 67.2 percent of physician practices are considering limiting the number of new Medicare patients, 49.5 percent are considering the option of refusing new Medicare patients, 56.3 are contemplating whether to reduce the number of appointments for current Medicare patients, and 27.5 percent are debating whether to cease treating all Medicare patients. [7]

Access problems for Medicare enrollees are not isolated to physicians. The nation's hospitals face a dire operating threat posed by the PPACA and the Independent Payment Advisory Board (IPAB).

Table 4 shows the hospital economic impact of the PPACA's inpatient hospital reimbursement cut on a sample of 401 non-profit stand-alone hospitals.[8] After taking into account the pending reimbursement cuts, more than 232 hospitals of the 401 surveyed would begin operating at net loss. As the Chief Actuary of CMS, Richard Foster, has stated in his illustrative alternatives to the Medicare Trustees report, the pending payment reductions to America's hospitals is simply unsustainable. While the payment reductions create the illusion of budget savings, they dramatically undercut the viability of the nation's hospitals.

Table 5 indicates the potential impact of losing just 232 hospitals. Among the nation's non-profit standalone hospitals these payment reductions may lead to a

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[6] Medical Group Management Association. 2010. Sustainable Growth Rate Study. http://www.mgma.com/WorkArea/DownloadAsset.aspx?id=39774

[7] Medical Group Management Association. 2010. Sustainable Growth Rate Study. http://www.mgma.com/WorkArea/DownloadAsset.aspx?id=39774

[8] Moody's Investors Service. *Not-for-Profit Healthcare Medians for Fiscal Year 2009.* August 25, 2010.

loss of as many as 69,000 hospital beds and a loss of ER capacity totaling more than 14 million visits. If applied more broadly to the country's entire hospital infrastructure, the forced closure of as many as 55 percent of the nation's hospitals due to PPACA's payment reductions would threaten America's ability to respond to national disasters. Medicare's status quo is fraying the nation's social safety net.

4. The Independent Payment Advisory Board is a dramatic policy error that will exacerbate reimbursement problems and stifle innovation.

As noted above, reimbursement concerns will increasingly affect the care opportunities for Medicare beneficiaries. In light of this, one of the most dangerous aspects of the *status quo* is the creation of the Independent Payment Advisory Board (IPAB). It should be repealed immediately.

This appointed panel has been tasked with cutting Medicare spending, but its poor design will prove ineffective in bending the cost curve, and instead will lead to restricted patients' access and stifled innovation.

By statute, IPAB cannot directly alter Medicare benefits. Instead, the more likely threat to patients is that the IPAB will be forced to limit payments for medical services. So it could decide that patients should have coverage for one particular treatment option but not another, or must pay much more for one of the treatment options.

This is especially troubling because it may choose to focus on expensive new treatments. New medicines for conditions like Alzheimer's or Parkinson's will likely have rapid cost growth, especially early after their introduction. That will make them targets because the IPAB is directed to focus on areas of "excess cost growth." Worse, because about one-half of spending is off limits until after 2020, there will be a disproportionate and uneven application of IPAB's scrutiny and payment initiatives.

Because IPAB's cuts have to be achieved in one-year periods there will be an enhanced focus on reimbursements at the expense of longer-run quality improvements or preventive programs. In this way IPAB could actually discourage rather than encourage a focus on quality improvement.

All of this suggests that IPAB is a potent mechanism for undesirable policy. So it is particularly troubling that IPAB is unaccountable. It decisions must be honored by the Secretary of HHS and it is structured to give Congress little ability to make the important policy choices.

The Independent Payment Advisory Board is at best a band-aid on out-of-control Medicare spending and at its worst a threat to physician autonomy and patient choice. Saving Medicare from ruin requires nothing short of total and

comprehensive reform. Adding in more cuts to a broken system does not make it any less broken. The IPAB proposals will be short-term fixes and cuts. We need long-term thinking and long-term solutions. We need to move the focus from merely containing costs to focus on how to get the most value for our health care dollars.

If Medicare's provider reimbursements are drastically reduced the market will react and, according to the basic laws of economics. Providers will have three options: to close up shop, to refuse Medicare patients, or to shift the costs onto the other patients. None of these options help our healthcare system operate more effectively or more efficiently.

Thank you and I look forward to answering your questions.