Backgrounder

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Medicare's Deepening Financial Crisis: The High Price of Fiscal Irresponsibility

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Medicare, the huge government insurance program that covers 41 million seniors and disabled citizens, is facing a major financial crisis. None of this is surprising.

Rising Costs

Title I of the Medicare Prescription Drug Improvement and Modernization Act of 2003 creates a new and complex universal prescription drug entitlement. According to the latest Medicare trustees report, the Medicare hospital insurance program will be exhausted in 2019, seven years earlier than the past year's estimate.[1] But that is just the tip of the iceberg. The hospital insurance trust fund does not include the new drug entitlement, and that alone will add $8.1 trillion to the program's long-term unfunded liabilities over the next 75 years.[2]

Medicare's massive costs will result in huge tax increases. According to Medicare Trustee Thomas R. Saving, a professor of economics at Texas A&M University and senior fellow at the National Center for Policy Analysis, the Medicare program is now projected to consume:

- 24 percent of all federal income taxes by 2019 and
- 51 percent of all federal income taxes by 2042.[3]

The true cost of the drug entitlement expansion is unknown, and the trustees could be understating the real cost. When the new Medicare law was enacted in 2003, the Congressional Budget Office (CBO) estimated the 10-year cost at $395 billion. Less than three months later, the White House Office of Man-

Talking Points

- According to the latest Medicare trustees report, the Medicare hospital insurance program will be exhausted in 2019, seven years earlier than the past year's estimate.
- The new drug entitlement will add $8.1 trillion to Medicare's unfunded liabilities over the next 75 years.
- Medicare is now projected to consume 24 percent of all federal income taxes by 2019 and 51 percent of all federal income taxes by 2042.

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agement and Budget (OMB) revealed that it estimated the 10-year cost at $534 billion.[4]

More recently, Richard S. Foster, Medicare's chief actuary, said, "All our estimates showed that the cost of the drug benefit, through 2013, would be in the range of $500 billion to $600 billion."[5] This is just for the next 10 years, before the baby-boom generation hits the program. All of the various government actuaries have concluded that taxpayers will likely pay far more than the initial official estimates for the first 10 years and trillions of dollars after that.

Ironically, the entire financial situation could be far worse. During the debate on the new drug entitlement, Democrats offered proposals that would have cost nearly $1 trillion in the first 10 years,[6] far in excess of anything proposed by the Administration or the congressional leadership. Many critics of the new drug program actually want a more expensive program.

Bad Drug Policy

When the new drug entitlement takes effect in 2006, seniors will pay an estimated $420 in additional drug-related premiums in the first year, plus a $250 deductible. The government would then pay 75 percent of drug costs up to $2,250. Above that amount, seniors would pay $3,600 out of pocket—the "doughnut hole"—before becoming eligible for catastrophic coverage, with the government paying 95 percent of catastrophic costs and seniors paying 5 percent. Unlike the hospitalization payments, which are drawn from dedicated taxes deposited in a trust fund, the government will pay for the drug benefit from general revenues.

In the meantime, the new Medicare law creates a prescription discount drug card, effective this year, that includes a $600 subsidy for low-income seniors. Unlike the subsidies provided for seniors under the drug entitlement, the drug card subsidies do not require an asset test for eligibility. The discount card is projected to save between 10 percent and 25 percent. For many seniors, especially poor seniors without coverage, this is an attractive program; it is also market-friendly and builds on existing private-sector entities. Remarkably, Congress has decided to kill this promising program after just two years of operation.

Thus, the drug discount card is temporary and expires in 2006, but the new drug entitlement is permanent and would take effect in 2006, accelerating the displacement of the existing drug coverage for millions of retirees, including the coverage that many seniors have today through former employers. So Congress has enacted a universal government drug entitlement, setting in motion dynamics that will crowd out other alternatives.

A Better Medicare Drug Policy

Congress made a huge mistake in enacting the universal drug entitlement and should deal with the emerging financial problems of Medicare, including the prescription drug problem, as quickly as possible. Specifically, Congress should:

1. **Delay the implementation of the universal drug entitlement scheduled for 2006.** Even without a prescription drug entitlement, Medicare is facing formidable financial challenges. A range of public and private-sector health policy analysts have repeatedly warned Congress of the

1. Centers for Medicare and Medicaid Services, *2004 Annual Report of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplemental Insurance Trust Funds*, March 23, 2004, p. 2, at *www.cms.hhs.gov/publications/trusteesreport*.
2. *Ibid.*, p. 109. The unfunded obligation over the 2003–2078 period is $8.1 trillion. The unfunded obligation over an infinite time horizon is $16.6 trillion. This year, the Medicare trustees have introduced an additional way to calculate the program's future costs and liabilities. This method, known as "infinite horizon," includes all current and future participants. Under this category, the unfunded obligation of the drug entitlement amounts to $16.6 trillion.
3. Thomas R. Saving, "Examining the 2004 Social Security and Medicare Trustees Reports," congressional briefing on behalf of the National Center for Policy Analysis, Washington, D.C., 2004.
4. The different cost estimates are the results of significant differences between CBO and OMB assumptions.
5. Robert Pear, "Democrats Demand Inquiry into Charge by Medicare Officer," *The New York Times*, March 14, 2004.
6. Sheryl Gay Stolberg and Robert Pear, "Mysterious Fax Adds to Intrigue over the Medicare Bill's Cost," *The New York Times*, March 18, 2004.

gravity of these challenges and have recommended serious structural changes to Medicare, such as a premium support financing system, to enable the program to deliver high-quality health care to future retirees.

In the meantime, Congress has not yet adopted a strong mechanism to cope with future entitlement costs and the unfunded liabilities that face current and future generations of taxpayers. This needs to be done before any new entitlement begins in 2006. In the face of these unmet challenges, there is no good reason for Congress to expand the Medicare entitlement, displace existing drug coverage, and accelerate the loss of drug coverage offered to retirees through former employers.

2. **Make the drug discount card program a permanent feature of Medicare.** The Centers for Medicare and Medicaid Services staff is already processing applications from over 100 companies that want to offer the drug discount cards on a regional or national basis. The infrastructure for a potentially successful program is already being established. There is no good reason to shut down the entire operation and deprive seniors of a personal choice. Indeed, the drug discount card program, combined with catastrophic coverage and even richer subsidies to low-income seniors, could be the foundation of a superior drug option for Medicare beneficiaries.

   Federal subsidies to low-income seniors, or those without drug coverage, could be delivered through debit cards issued by private health plans. Any qualified health plan that provides for catastrophic coverage and meets current federal or state insurance regulations should be able to participate. Income-related subsidies could be channeled through qualified health plans. This would give Medicare beneficiaries a strong incentive to sign up for drug coverage and minimize adverse selection.

   Like the entities offering the drug discount cards, the plans could be national or regional and could be required to disclose information that would allow for consumer comparisons. Consumer comparisons are routine under the Federal Employees Health Benefits Program (FEHBP), the popular and successful program used by federal employees and retirees.

3. **Integrate the drug discount card program into the new Medicare Advantage program.** Medicare beneficiaries should be allowed to continue to use the drug discount card, and the subsidies for low-income seniors should be retained or even increased. In 2006, the Medicare Advantage health plans, including new regionally based preferred provider organizations, will be available to seniors. These health plans should have the opportunity to integrate the drug discount card and low-income drug assistance programs into their health plan offerings. Unspent funds for those who are subsidized through the discount card could be rolled over tax-free from year to year, much like a health savings account.

Conclusion

Taxpayers face a serious financial problem in the Medicare program. As Professor Tom Saving, a Medicare public trustee, has reported, the program is projected to consume over half of all federal income taxes by 2042.[7]

Taxpayers can expect the real costs of the drug entitlement to be much greater than the initial published estimates. Worse, some Members of Congress are claiming that the current drug entitlement subsidy is not enough and want to fill the entitlement's unpopular "doughnut hole" and double the initial expenditures on the new entitlement. Such prescriptions would not only worsen Medicare's already difficult financial problems, but also pave the way for government restrictions on prescription drugs for seniors. To control costs of the drug entitlement program, the government would somehow have to limit the supply of drugs, probably through tighter drug formularies or some form of government price fixing or purchasing mechanism. Yet, with demand for prescription drugs rising rapidly,

7. Saving, "Examining the 2004 Social Security and Medicare Trustees Reports."

the government cannot provide more by paying less.

There is a better alternative. Members of Congress should get a handle on the exploding costs of the Medicare program before implementing a universal entitlement expansion. To that end, they should at least delay implementation of the drug entitlement while making the prescription drug discount a permanent feature of Medicare, including the new Medicare Advantage system that will take effect in 2006. Such a policy could establish the foundation for a more rational and responsible Medicare drug program: one that accommodates, rather than displaces, a wide variety of private-sector drug options.

Of course, Congress can also choose to do nothing.

But nothing will be very expensive.

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