

Background

No. 1849
April 28, 2005



Published by The Heritage Foundation

Medicare Drug Cost Estimates: What Congress Knows Now

Derek Hunter

[W]e as a Congress have an obligation to try to fix [those entitlement programs] today so that they don't end up bankrupting our children and our children's children tomorrow.

—Senator Judd Gregg (R-NH)¹

There is no way we are going to deliver all the Medicare promises that have been made. No way.

—David M. Walker, U.S. Comptroller General²

Since the Administration's release of its latest 10-year cost estimates for the Medicare drug bill, many Members of Congress say they are in a state of sticker shock, and taxpayers are confused and suspicious. More recent estimates of the bill's cost are far higher than the 2003 estimates on which Congress relied when voting on the bill.

When Congress enacted the Medicare Modernization Act (MMA) in November 2003, it relied on cost estimates by the Congressional Budget Office (CBO). The CBO estimated the 10-year cost of the drug provisions at \$394 billion for the period 2004 to 2013.

The Centers for Medicare and Medicaid Services (CMS), the agency that runs the Medicare program, generated its own estimate in 2003 and has continued to do so every year since the bill's enactment. Though not made public until 2004, the CMS's 2003 estimate was \$534 billion for the period 2004 to 2013. In CMS's February 2005 estimate, the 10-year price tag of the drug provision is \$724 billion for the period 2006 to 2015.

Talking Points

- All competing estimates of the Medicare drug program have increased. In 2003, the CBO estimated that this entitlement would cost \$25.7 billion in 2006, its first year. Today, using different assumptions, the CMS estimates that it will cost \$37.4 billion in 2006—\$11.7 billion more than the original CBO estimate.
- The Part D drug entitlement accounts for nearly 30 percent (\$8.7 trillion) of Medicare's \$29.7 trillion unfunded liability.
- By 2020, Medicare will require 25 percent of all federal income taxes to meet current commitments. By 2040, it will require 50 percent.
- Postponing the start of the entitlement by one year and extending the life of the Medicare drug discount card could save tens of billions of dollars, even if Congress increased both the federal subsidy on the drug card and the income eligibility for the subsidy.

This paper, in its entirety, can be found at:
www.heritage.org/research/healthcare/bg1849.cfm

Produced by the Center for Health Policy Studies

Published by The Heritage Foundation
214 Massachusetts Avenue, NE
Washington, DC 20002-4999
(202) 546-4400 • heritage.org

Nothing written here is to be construed as necessarily reflecting the views of The Heritage Foundation or as an attempt to aid or hinder the passage of any bill before Congress.

Table I

B 1849

Competing Estimates of the Medicare Drug Entitlement

Original CBO vs. Original CMS
(in \$billions)

Fiscal Year	2006	2007	2008	2009	2010	2011	2012	2013	Total
Original CBO Estimates, November 2003	25.7	39.0	44.6	48.7	53.7	58.6	65.3	73.1	408.7
Original CMS Estimates, 2003	35.0	51.0	55.4	60.2	65.3	71.0	79.0	88.6	505.5
Increase	9.3	12.0	10.8	11.5	11.6	12.4	13.7	15.5	96.8
Percentage Increase	36.2%	30.8%	24.2%	23.6%	21.6%	21.2%	21.0%	21.2%	23.7%

Sources: Douglas Holtz-Eakin, Director, Congressional Budget Office, letter and attached chart to Representative Bill Thomas (R-CA), Chairman, Committee on Ways and Means, U.S. House of Representatives, November 20, 2003, at www.cbo.gov/showdoc.cfm?index=4808&sequence=0 (April 21, 2005), and Centers for Medicare and Medicaid Services, "Comparison of CMS's Original Title I MMA Cost Estimates to Those Underlying the President's FY 2006 Budget," attached to unpublished e-mail from Julie Goon, Centers for Medicare and Medicaid Services, February 09, 2005.

Competing Estimates

The difference between the two CMS estimates is easily explained. Members of Congress should not be surprised. White House press secretary Scott McClellan correctly observes that comparing the two 10-year totals is akin to "comparing apples to oranges."³

Specifically, the previous estimates were for the time period 2004 to 2013. Since the full-blown drug entitlement does not begin until 2006, the 2004 to 2013 estimate includes two years of the significantly less expensive Medicare Drug Discount Card (MDDC), which offers targeted, substantial help to needy seniors.⁴ Only eight years involve the new prescription drug program's higher costs. The newer estimates, for the period 2006 to 2015, include 10 years of the new entitlement—hence the major difference between the two estimates.

New Taxpayer Costs

The true significance of the latest CMS estimate is that this number is the taxpayers' first glimpse of

the drug entitlement's enormous cost, which will soon grow dramatically as the baby-boom generation retires. These drug costs will aggravate the already enormous unfunded liabilities of the entire Medicare program. For example:

- **Taxpayers will face an estimated \$29.7 trillion in unfunded Medicare liabilities.** According to the latest Medicare Trustees Report, the estimated total of unfunded Medicare benefits increased by \$2 trillion in just one year.
- **Taxpayers will pay trillions of dollars to cover the Medicare drug costs.** The latest Medicare trustees' estimate of unfunded drug entitlement liabilities alone is \$8.7 trillion over a 75-year period.
- **Taxpayers will pay an increasing share of their income taxes just to keep Medicare afloat.** Under current law and assumptions, Dr. Thomas Saving, a former Medicare public trustee (his term expired after the 2005 Trustees Report was issued), estimates that the pro-

1. Bill Swindell, "Senate Committee Members Say It's Time to Control Medicare's Surging Costs," *CQ Today*, February 8, 2005.
2. *Ibid.*
3. Robert Pear, "Estimate Revives Fight on Medicare Costs," *The New York Times*, February 10, 2005, p. A20.
4. For more information on the Medicare Drug Discount Card, see Derek Hunter, "The Truth About the Medicare Drug Discount Card," Heritage Foundation *Background* No. 1766, May 28, 2004, at www.heritage.org/Research/HealthCare/bg1766.cfm, and Derek Hunter, "The Medicare Drug Discount Cards: One Month In," Heritage Foundation *WebMemo* No. 538, July 15, 2004, at www.heritage.org/Research/HealthCare/wm538.cfm.

Table 2

B 1849

Competing Estimates of the Medicare Drug Entitlement

Original CBO vs. New CMS
(in \$billions)

Fiscal Year	2006	2007	2008	2009	2010	2011	2012	2013	Total
Original CBO Estimates, November 2003	25.7	39.0	44.6	48.7	53.7	58.6	65.3	73.1	408.7
New CMS Estimates, February 2005	37.4	52.5	57.1	62.0	67.0	72.1	79.6	88.5	516.2
Increase	11.7	13.5	12.5	13.3	13.3	13.5	14.3	15.4	107.5
Percentage Increase	45.5%	34.6%	28.0%	27.3%	24.8%	23.0%	21.9%	21.1%	26.3%

Sources: Douglas Holtz-Eakin, Director, Congressional Budget Office, letter and attached chart to Representative Bill Thomas (R-CA), Chairman, Committee on Ways and Means, U.S. House of Representatives, November 20, 2003, at www.cbo.gov/showdoc.cfm?index=4808&sequence=0 (April 21, 2005), and Centers for Medicare and Medicaid Services, "Comparison of CMS's Original Title I MMA Cost Estimates to Those Underlying the President's FY 2006 Budget," attached to unpublished e-mail from Julie Goon, Centers for Medicare and Medicaid Services, February 09, 2005.

gram will consume 25 percent of all federal income taxes by 2020 and 50 percent of all federal income taxes by 2040.

Thus, the financial burdens of the expanded Medicare entitlement pose a challenge for, and impose an enormous burden on, both current and future taxpayers. Even though the latest revelations of the Medicare drug bill's 10-year cost should not surprise Members of Congress, their anxiety is well founded. The most recent CMS estimates reflect a reality that is very different from what many thought to be the case in November 2003, as congressional leadership rushed the Medicare bill through passage in both houses of Congress, based solely on the CBO estimates.

A Responsible Policy

Once an entitlement is in place, it is nearly impossible to repeal or limit it.⁵ The most sensible option for Congress is to repeal the drug entitlement provisions of Title 1 of the Medicare Modernization Act of 2003 before they take effect. Meanwhile, Congress could target direct and generous assistance to seniors who are without drug coverage, particularly poor seniors.

Short of repeal, the next best option is delay. Delaying the starting date from January 1, 2006, to January 1, 2007, would save nearly \$40 billion in 2006 alone.⁶ Accordingly, Representative Jeff Flake (R-AZ) has introduced the Prescription Drug COST (Control Overspending to Save Taxpayers) Containment Act of 2005 (H.R. 1382) to delay the start of the drug entitlement while extending the life of the Medicare drug discount cards, which are intended for seniors who actually need help with the cost of their prescription drugs.

Moreover, some of the nearly \$40 billion in savings from the proposed one-year delay could be rolled over into the MDDC program, thereby expanding the subsidy to low-income seniors and allowing more seniors to qualify for that subsidy. This would increase aid to seniors who are in actual need while temporarily relieving taxpayers of much of the new entitlement's crushing cost.

Behind the Different Medicare Estimates

As noted, Congress voted for the MMA based on the CBO cost estimate, the only estimate available to Members at the time. The CBO priced Title I (the prescription drug benefit) at \$409.8 billion over 10

5. The one major exception is the Medicare Catastrophic Coverage Act of 1988.

6. Centers for Medicare and Medicaid Services, "Comparison of CMS's Original Title I MMA Cost Estimates to Those Underlying the President's FY 2006 Budget," attached to unpublished e-mail from Julie Goon, Centers for Medicare and Medicaid Services, February 9, 2005.

Table 3

B 1849

Competing Estimates of the Medicare Drug Entitlement

Original CMS vs. New CMS (in \$billions)

Fiscal Year	2006	2007	2008	2009	2010	2011	2012	2013	Total
Original CMS Estimates, 2003	35.0	51	55.4	60.2	65.3	71.0	79.0	88.6	505.5
New CMS Estimates, February 2005	37.4	52.5	57.1	62.0	67.0	72.1	79.6	88.5	516.2
Increase	2.4	1.5	1.7	1.8	1.7	1.1	0.6	-0.1	10.7
Percentage Increase	6.9%	2.9%	3.1%	3.0%	2.6%	1.5%	0.8%	-0.1%	2.1%

Sources: Douglas Holtz-Eakin, Director, Congressional Budget Office, letter and attached chart to Representative Bill Thomas (R-CA), Chairman, Committee on Ways and Means, U.S. House of Representatives, November 20, 2003, at www.cbo.gov/showdoc.cfm?index=4808&sequence=0 (April 21, 2005), and Centers for Medicare and Medicaid Services, "Comparison of CMS's Original Title I MMA Cost Estimates to Those Underlying the President's FY 2006 Budget," attached to unpublished e-mail from Julie Goon, Centers for Medicare and Medicaid Services, February 09, 2005.

years. After savings in other areas, the estimated total cost of the law was \$394 billion.⁷ In March 2004, Congress and the public learned that the CMS had done its own cost projections on the MMA and had estimated the 10-year price tag at \$534 billion.⁸ The CMS and the CBO used different assumptions as to which and how many seniors would sign up for the program. These account for most of the difference,⁹ but the real story goes deeper.

Whether made by the CBO, the CMS, the Office of Management and Budget, or independent health policy analysts, health care program cost projections are a profoundly difficult exercise. Slight changes in assumptions can dramatically affect these estimates, just as unforeseen external factors can cause actual costs to vary greatly.

Tables 1, 2, and 3 compare the three sets of projections for the prescription drug benefit's first eight years. (The CBO estimate includes 2004 and 2005, two years prior to the drug entitlement's 2006 start, but the CMS estimate does not. Similarly, the CMS estimates include 2014 and 2015, but the CBO's

does not. Therefore, these 10-year estimates provide only eight years' overlap for comparison.)

In summary, the original CMS estimate for the period 2006 to 2013 is 23.7 percent higher than the CBO estimate for the same period. The more recent CMS numbers are even higher: 26.3 percent higher than the CBO estimate.

Recalling Medicare Catastrophic. Congressional experience with the Medicare Catastrophic Coverage Act of 1988 directly relates to the current Medicare debate. That bill passed by huge majorities in the House and Senate, and enjoyed the Reagan Administration's support. It also included a prescription drug benefit.

However, there is a major ironic difference between that Medicare drug benefit and today's drug entitlement, which was cobbled together by a Republican congressional majority. The 1988 bill was self-financing; those who would receive the drug benefits would pay for them. The 2003 bill is not self-financing; it is an open-ended entitlement, largely financed by the taxpayers out of general revenues.

7. Douglas Holtz-Eakin, Director, Congressional Budget Office, letter and attached chart to Representative Bill Thomas (R-CA), Chairman, Committee on Ways and Means, U.S. House of Representatives, November 20, 2003, at www.cbo.gov/showdoc.cfm?index=4808&sequence=0 (April 21, 2005).

8. Amy Goldstein, "Official Says He Was Told to Withhold Medicare Data," *The Washington Post*, March 13, 2004, p. A1.

9. See Derek Hunter, "How the Drug Entitlement Drives Different Medicare Cost Estimates," Heritage Foundation *WebMemo* No. 464, April 1, 2004, at www.heritage.org/Research/HealthCare/wm464.cfm#_ftn6.

Although the 1988 Medicare drug provision was designed to be self-financing, its costs ballooned out of control, and the Medicare Catastrophic Coverage Act of 1988 was repealed after a little over a year. Contributing factors included growing senior opposition and exploding cost estimates, but the exploding cost estimates are positively minuscule compared to the enormous obligations that the Medicare Modernization Act of 2003 imposes. As Robert E. Moffit, Director of the Center for Health Policy Studies at The Heritage Foundation and a Reagan appointee at the Department of Health and Human Services in 1988, recalls:

The Congressional Budget Office's (CBO) estimate of the annual cost of the 1988 drug benefit jumped from \$5.7 billion when the bill was passed to \$11.8 billion just twelve months later. The CBO raised the cost of a new skilled nursing benefit from \$2.1 billion to \$13.5 billion, or by 642 percent, in just 14 months.¹⁰

While the recent CMS increase in the estimated cost of the MMA is striking across the board, the most disturbing numbers are for the first years. Estimates are more likely to be accurate in the early years than in later years. For example, in its 2003 estimates for 2006, the first year of the entitlement, the CMS exceeded CBO estimates by 36.2 percent, or \$9.3 billion. For 2007, the second year of the entitlement, CMS estimates are 30.8 percent, or \$12 billion, higher. (See Table 4.)

First-Year Drug Costs. Now that the CMS has released new cost estimates, the discrepancy relative to the 2003 CBO estimate is even greater. For just 2006, the program is estimated to cost \$37.4 billion—\$11.7 billion more than the CBO estimate that Members of Congress had available when they voted for the MMA. (See Table 4.)

Table 4

B 1849

Estimating the First Two Years of the Medicare Drug Entitlement

Original CBO vs. Original CMS

(in \$billions)

Fiscal Year	2006	2007
Original CBO Estimates, November 2003	25.7	39.0
Original CMS Estimates, 2003	35.0	51.0
Increase	9.3	12.0
Percentage Increase	36.2%	30.8%

Estimating the First Two Years of the Medicare Drug Entitlement

Original CBO vs. New CMS

(in \$billions)

Fiscal Year	2006	2007
Original CBO Estimates, November 2003	25.7	39.0
New CMS Estimates, February 2005	37.4	52.5
Increase	11.7	13.5
Percentage Increase	45.5%	34.6%

Estimating the First Two Years of the Medicare Drug Entitlement

Original CMS vs. New CMS

(in \$billions)

Fiscal Year	2006	2007
Original CMS Estimates, 2003	35.0	51.0
New CMS Estimates, February 2005	37.4	52.5
Increase	2.4	1.5
Percentage Increase	6.9%	2.9%

Sources: Douglas Holtz-Eakin, Director, Congressional Budget Office, letter and attached chart to Representative Bill Thomas (R-CA), Chairman, Committee on Ways and Means, U.S. House of Representatives, November 20, 2003, at www.cbo.gov/showdoc.cfm?index=4808&sequence=0 (April 21, 2005), and Centers for Medicare and Medicaid Services, "Comparison of CMS's Original Title I MMA Cost Estimates to Those Underlying the President's FY 2006 Budget," attached to unpublished e-mail from Julie Goon, Centers for Medicare and Medicaid Services, February 09, 2005.

10. Robert E. Moffit, "The Last Time Congress Reformed Health Care: A Lawmaker's Guide to the Medicare Catastrophic Debacle," Heritage Foundation *Background* No. 996, August 4, 1994, at www.heritage.org/Research/HealthCare/bg996.cfm.

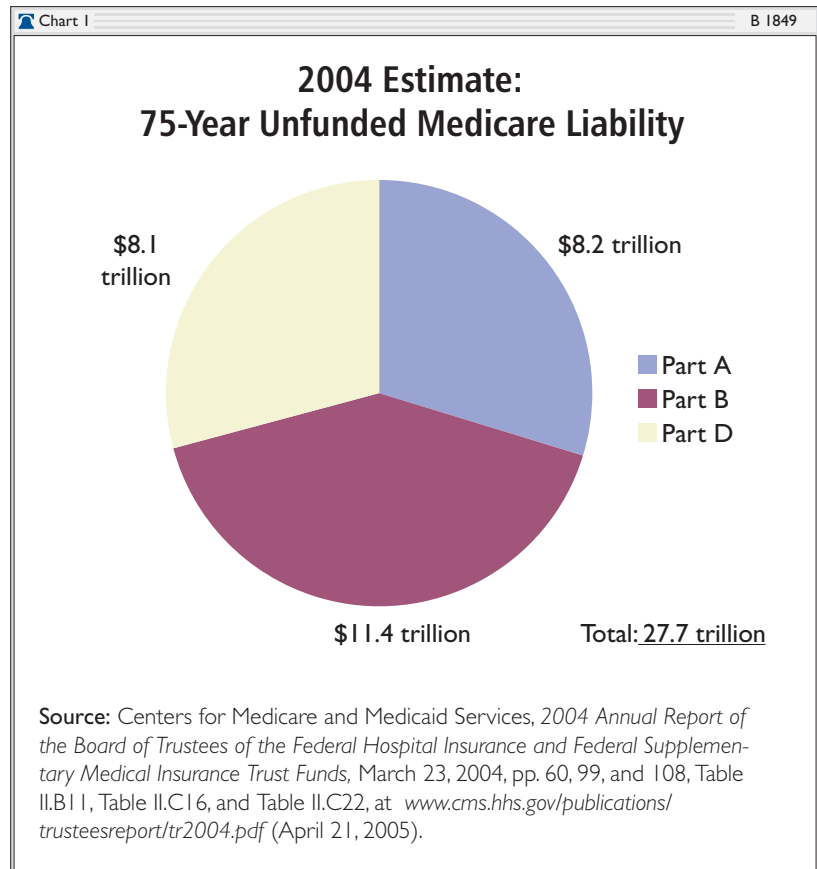
The CMS has increased its own estimates for the first year of the drug entitlement. Originally, the CMS put the price tag for 2006 at \$35 billion; now it puts it at \$37.4 billion. This is a 6.9 percent increase for the same time period, from the same agency, for the same program, in 14 months.

The Price Taxpayers Will Pay for Congressional Inaction

Just as the cost of the prescription drug entitlement (Part D) will continue to grow, so will the cost of the rest of Medicare, including both Part A (hospital insurance) and Part B (supplemental medical insurance). This will only increase Medicare's massive unfunded liability.¹¹ The 2004 annual report of the Social Security and Medicare trustees estimated the unfunded liability for Medicare over the next 75 years to be \$27.7 trillion, \$8.1 trillion of which is directly attributable to the prescription drug entitlement.¹² The passage of the MMA in 2003 is therefore responsible for nearly 30 percent of Medicare's overall unfunded liability.

Bigger Liabilities. The 2005 Trustees Report has increased that number to \$29.7 trillion, with \$8.7 trillion directly attributed to drug entitlement.¹³ This is an increase of \$2 trillion in just one year, including an additional \$600 billion, or 7.5 percent, for the drug entitlement alone (Part D).

For perspective, according to *Forbes*, the combined wealth of the 400 richest Americans reached



\$1 trillion for the first time in 2004.¹⁴ The further one pushes the 75-year window into the future, the larger grows the burden of unfunded Medicare liabilities on future generations of taxpayers.

Medicare's Increasing Share of Federal Income Taxes. As the cost of Medicare Parts A, B, and D continues to increase over the next 75 years, the share of federal income tax revenues required to pay bills not funded by the traditional sources of

11. The unfunded liability is the amount that the program will cost over and above what current revenues will provide to the program.
12. Centers for Medicare and Medicaid Services, *2004 Annual Report of the Board of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds*, March 23, 2004, pp. 60, 99, and 108, Table II.B11, Table II.C16, and Table II.C22, at www.cms.hhs.gov/publications/trusteesreport/tr2004.pdf (April 21, 2005).
13. Centers for Medicare and Medicaid Services, *2005 Annual Report of the Board of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds*, March 23, 2005, pp. 92, 101, and 112, Table III.C10, Table III.C15, and Table III.C21, at www.cms.hhs.gov/publications/trusteesreport/tr2005.pdf (April 21, 2005).
14. David Armstrong and Peter Newcomb, eds., "The Forbes 400," *Forbes*, October 11, 2004, at www.forbes.com/free_forbes/2004/1011/103.html&r104 (April 21, 2005).

Medicare funding (premiums, payroll taxes, etc.) will grow exponentially. Dr. Thomas R. Saving, one of the program's two public trustees, estimates that Medicare will consume 25 percent of all federal income taxes by 2020 if nothing is done to reform it.¹⁵ By 2040, fully 50 percent of every dollar collected through the federal income tax system will have to be spent on Medicare just to pay the bills in excess of funds received from traditional sources. (See Chart 3.)

The trade-offs are painful. Assuming no change, either America's taxpayers face massive tax increases, or seniors would face giant premium hikes or benefit cuts, or Congress must enact major cuts in non-Medicare government spending. However, the better course of action would be to reform the Medicare system as soon as possible by changing the structure of the program and repealing or delaying the universal drug entitlement before it goes into effect on January 1, 2006.

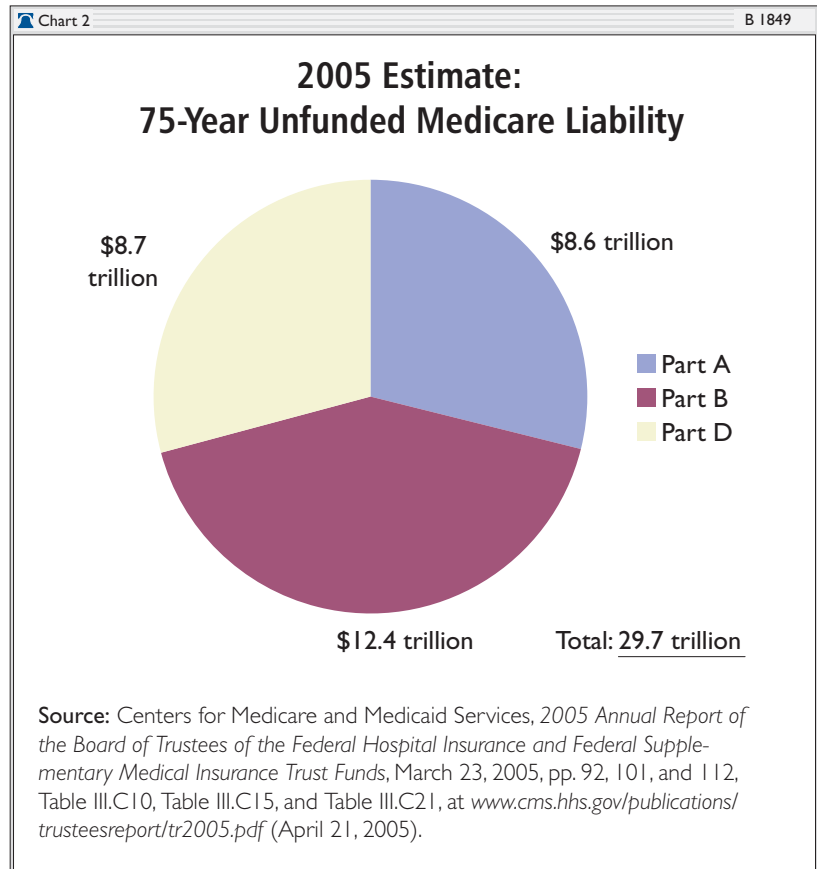
Conclusion

The Administration's latest \$724 billion 10-year Medicare drug cost estimate should not surprise Members of Congress. It is a cost projection for a massively expensive, open-ended entitlement, the costs of which will grow every year. In a sense, it almost does not matter whether one uses CBO or CMS numbers: Either way, costs will soar; only the rates differ. In fact, historically, every proposed Medicare drug benefit has included a larger price tag than the one preceding it.¹⁶

The real significance of Medicare sticker shock is that it marks America's first glimpse into the soaring future costs of the drug entitlement. Congress

can act now to revisit the Medicare law by targeting drug subsidies to low-income seniors who are without coverage and therefore lessening the deepening fiscal crisis in Medicare. This can be done this year, either by postponing the drug entitlement before it goes into effect on January 1, 2006, or by repealing it.

Representative Flake's proposed Prescription Drug COST Containment Act of 2005 would simply push back the entitlement's starting date by one year and extend the life of the Medicare Drug Discount Card to cover that year. This would be a good start, saving taxpayers nearly \$40 billion in 2006 alone and ensuring that seniors in need would con-



15. Thomas R. Saving, "Perspectives on the 2005 Social Security and Medicare Trustees Reports," slides for presentation at congressional briefing, "Analyzing the 2005 Social Security and Medicare Trustees Report," National Center for Policy Analysis, Washington, D.C., March 23, 2005, at www.ncpa.org/evn/washington/2005-perspectives.pdf (April 21, 2005).

16. See Derek Hunter, "The Sky's the Limit: Medicare's Upwardly Mobile Drug Cost Projections," *Heritage Foundation WebMemo* No. 326, August 12, 2003, at www.heritage.org/Research/HealthCare/wm326.cfm.

tinue to have help with the cost of prescription drugs.

In any case, Members of Congress cannot now pretend they do not know the true dimensions of the nation's looming financial problems—even if they insist that they did not know of them in November 2003, when they enacted the largest entitlement expansion since Lyndon Johnson's Great Society.

—Derek Hunter is a Research Assistant in the Center for Health Policy Studies at The Heritage Foundation.

