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The President's Medicare Budget Proposal: A Step Forward on Entitlement Spending

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America's taxpayers, particularly young people, must somehow find a way to cope with a long-term Medicare debt of \$32.4 trillion.¹ This amount represents the value today of Medicare's long-term unfunded promises not financed by any dedicated revenues under current law. It includes approximately \$8 trillion due to the 2003 Medicare drug entitlement.

The cost of the Medicare program is rising rapidly, and this growth will accelerate when the first wave of 77 million baby boomers starts to retire in 2011. In fiscal year 2008, Medicare benefits will total \$454 billion, an increase of \$28 billion over last year, to cover almost 45 million senior and disabled citizens. In his FY 2008 budget, the President has proposed a set of serious Medicare proposals that will begin to address this enormous fiscal challenge.

A Bold Budget Initiative. The President's budget calls for savings of \$76 billion over the next five years through a combination of administrative and legislative proposals, which, if implemented, would reduce the Medicare program's total rate of growth from a projected 6.5 percent to 5.6 percent.² Meanwhile, it would reverse the projected decline of the Hospital Insurance (HI) Trust Fund, the part of the Medicare program that reimburses hospitals. Under current law, the HI Trust Fund would become insolvent in 2018.³

But the most important feature of the President's budget plan is that, over the long term, it would accomplish a major objective: starting to reduce the

huge long-term unfunded liabilities of the Medicare program. Indeed, it would reduce the enormous unfunded obligations of the program by an estimated \$8 trillion, or one-fourth of the projected red ink.⁴

Specific Budget Proposals. The main provisions that would yield substantial savings are as follows:

- **Limiting Taxpayer Subsidies to Wealthy Beneficiaries:** Under Medicare Part B, which pays for doctors and outpatient medical services, coverage is voluntary and is financed with premiums paid by beneficiaries and the taxpayers. Under current law, most seniors pay only 25 percent of the premiums for the Medicare Part B benefits; taxpayers finance the remaining 75 percent through general revenue transfers. There is one exception: Beneficiaries with an annual income of \$80,000, if single, or \$160,000, if married, do pay higher premiums, though this income threshold is indexed and so will rise in future years. Under the President's proposal, the annual indexing of income-related Part B premiums would be eliminated, so the income threshold would not be adjusted upward each year. This would yield an estimated savings of \$7.1 billion over the period from 2008 to 2012.⁵

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- **Extending Part B Income-Related Rules to Part D:** The President's proposal would extend his modified Medicare Part B rules for reduced taxpayer subsidies to upper-income beneficiaries of the Part D drug entitlement. Under this proposal, taxpayers would save \$3.2 billion over the period from 2008 to 2012.⁶
 - **Reducing Medicare Payments:** Payment for services in Medicare is governed by a complex and cumbersome system of administrative pricing. Under current law, Congress establishes payment formulas, fee schedules, and caps on what can be charged to Medicare beneficiaries for the thousands of services that are delivered each year. To be sure, micromanaging prices is a profoundly inefficient way to reimburse doctors, hospitals, and other medical professionals. But currently the only way that Congress can secure savings is to readjust reimbursement formulas. Under the President's proposal, these reimbursement formulas would be changed, reducing payments to a wide variety of providers, including hospitals, skilled nursing facilities, inpatient rehabilitation facilities, hospice services, outpatient hospital care, ambulance fee schedules, ambulatory surgical centers, and home health care services. The President's plan would also introduce competitive bidding for clinical laboratory services. Under the President's proposal, these changes would yield savings of \$41.9 billion over the period from 2008 to 2012.⁷
- The President's budget also calls for "rationalizing" Medicare payments and direct subsidies by changing or reducing reimbursements or subsi-

dies for a variety of other miscellaneous items, including certain hospital services, acute care conditions in nursing facilities, wheelchairs, and oxygen equipment. This proposal would yield an estimated \$11.4 billion in savings over the period from 2008 to 2012.⁸

A Lesson for Congress. In Medicare Part D, in which private-sector negotiation and market competition sets prices, projected premium costs for beneficiaries and the cost of the entire program are actually declining from earlier projected levels. Indeed, thanks to this system of market competition, total program costs are 30 percent lower than originally projected.⁹ So to improve on the President's budget proposal, Congress should begin the transformation of Medicare from the existing system based on central planning and price controls to a new system based on defined contribution, or "premium support," broadly similar to the Federal Employees Health Benefits Program (FEHBP). Such a system would be far superior to the current Medicare program in performance, efficiency, and cost control.

Congress's traditional inaction in addressing Medicare's long-term problems has only made future policy choices more difficult with each passing year. The President's proposal is a refreshing first serious step in demonstrating leadership on America's looming entitlement crisis. It recognizes that the huge unfunded obligations of entitlements must be bought under control rather than simply handed to our children and grandchildren.

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1. This is based on a 75-year actuarial projection. See David C. John and Robert E. Moffit, Ph.D., "Medicare and Social Security: Big Entitlement Costs on the Horizon," *Heritage Foundation WebMemo No. 1054*, May 1, 2006, at www.heritage.org/research/budget/wm1054.cfm.
2. U.S. Department of Health and Human Services, *Fiscal Year 2008 President's Budget for HHS*, Medicare, February 2008, p. 57.
3. *Ibid.*, p. 51.
4. Office of Management and Budget, *Budget of The United States Government, Fiscal Year 2008*, February 2007, p. 64.
5. *Ibid.*
6. *Ibid.*
7. *Ibid.*
8. *Ibid.*
9. *Budget of The United States Government, Fiscal Year 2008*, p. 66.