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Time to Get Serious (Again) About Medicare Reform

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The Medicare Trustees have released the annual report on the financial status of the Medicare program.[1] *The Washington Post's* front page headline on the report warns of a "Medicare Collapse."[2]

The basic facts are simple and dramatic:

- Medicare has an unfunded liability of almost $38 trillion;
- Medicare's hospital insurance trust fund will become insolvent in 2017;
- Congress has ignored funding warnings; and
- American households will inherit hundreds of thousands of dollars worth of debt.

While some in Washington say that Medicare reform should wait until Congress somehow fixes the broader health care system, the truth is that Medicare itself is a major driver of health care costs. Within three years, the first wave of the gigantic baby boom generation will start to retire and impose a demand on medical services unprecedented in the nation's history. The traditional Medicare program is not capable of absorbing such a shock without some fundamental changes.

What the Trustees Report Says. According to the 2009 Medicare Trustees Report, Medicare expenditures were $468 billion in 2008. But going forward, Medicare expenditures are projected to increase faster than workers' wages and the economy as a whole. In 2008, Medicare's annual costs were 3.2 percent of gross domestic product (GDP). Over the next 75 years—the time frame for long-term actuarial projections—these annual costs are projected to grow substantially, reaching 11.4 percent of GDP.

Trillions in Debt. The trustees estimate that Medicare's long-term unfunded obligation—the benefits promised but unpaid for—totals $37.8 trillion, or more than two-and-a-half times the current size of the entire U.S. economy.

Medicare Part A—Medicare's Hospital Insurance (HI) Trust Fund, or the part of Medicare that pays hospital bills—will again spend more in benefits than it receives in revenues. The trustees project that the HI fund will become insolvent by 2017, two years earlier than projected in last year's report. The trustees consider the earlier insolvency of the HI trust, which was largely a consequence of the recent economic downturn and reductions in payroll tax revenues, an "urgent concern" that will "require substantial changes" even in the short term.

Medicare Part B (which pays doctors' bills and other outpatient expenses) and Medicare Part D (which pays for prescription drugs), grouped under the Supplementary Medical Insurance (SMI) Trust Fund, will never become "insolvent." They will just impose greater burdens on taxpayers as they automatically draw down funds from the Trea-

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sury each year to pay three quarters of the medical bills incurred.

The SMI portion of Medicare will increasingly rely on larger and larger amounts of general revenues to finance the open-ended demand for medical benefits. In the short term, changes in Social Security as a consequence of the economic downturn will indirectly impact Medicare. The trustees expected that about 25 percent of Part B enrollees will face unusually large premium increases in the next two years largely due to a "hold harmless" provision in current law that limits premium increases for approximately 75 percent of seniors enrolled in Part B.

Clearly, Medicare's fiscal challenges are large, but those challenges may, in fact, be larger than indicated by the trustees report for a number of reasons:

- The economic stimulus included Medicare incentive payments to promote the adoption of electronic medical records that could accelerate the insolvency of the HI trust fund by six months;
- Trustees projections assume current law and therefore fail to take into account the annual costs of Congress offsetting reductions in physician payments; and
- The Medicare trustees assume the growth in health care costs will slow sooner and faster than the Congressional Budget Office and other analysts predict.

Ignoring Another Medicare Funding Warning. Under the Medicare Modernization Act of 2003, Congress set a trigger to address Medicare's large and growing unfunded obligation. If more than 45 percent of Medicare expenditures were projected to come from general revenues (as opposed to dedicated revenues such as payroll taxes and beneficiary premiums) within a seven-year actuarial period, the trustees would issue an "excess general revenue Medicare funding" determination in their annual report. Two consecutive "excess general revenue Medicare funding" determinations generate a "Medicare funding warning," triggering action by the President and Congress. The President is required to address the funding warning in legislation within 15 days of the next budget, and the proposal needs to receive expedited consideration in Congress.

Given the projected growth in Medicare expenditures, for the fourth consecutive year the trustees made an "excess general revenue Medicare funding" determination, triggering the third "Medicare funding warning" as a result of the program's excessive reliance on general revenues as part of its overall financing.

While Congress initially enacted the Medicare "trigger" in 2003 to call attention to the substantial financial challenges facing the Medicare program, the current Congress voted to ignore the trigger.[3]

Despite repeated public commitments to reforming unsustainable entitlement programs, President Obama's budget submission did not include a proposal to address the funding warning issued last year. Although Congress has chosen to ignore the Medicare trigger, the requirement that the President submit reform legislation to Congress each year following a Medicare funding warning—as toothless as that requirement is—still stands.

Ignoring Medicare Reform. Most analysts expect the forthcoming health reform proposal to cost taxpayers $1 trillion–$1.5 trillion over 10 years. Yet the President's budget proposal, which includes a $635 billion health care "reserve fund," is short on real savings.

In the meantime, representatives of the health care industry have joined with the President and pledged to reduce the annual growth in health care

1. Boards of Trustees, Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Fund, "2009 Annual Report," May 12, 2008, at *http://www.cms.hhs.gov/ReportsTrustFunds/downloads/tr2009.pdf* (May 13, 2009). For the message to the public, see Social Security Administration, "Message to the Public," at *http://www.ssa.gov/OACT/TRSUM/tr09summary.pdf* (May 13, 2009).
2. Amy Goldstein, "Alarm Sounded on Social Security: Report Also Warns of Medicare Collapse," *The Washington Post*, May 13, 2009, p. A-1.
3. H.Res. 5, "Adopting Rules for the One Hundred Eleventh Congress," passed the House without amendment on January 6, 2009.

costs by 1.5 percentage points—cutting $2 trillion in costs over 10 years by adopting cost-savings measures such as health information technology, care coordination, disease management, and "evidence-based" medicine.

The Congressional Budget Office and other independent analysts say that such measures are unlikely to deliver the level of savings hoped for—or required to pay for—health care reform. Most of the health care cost savings would occur in Medicare but are not dedicated to reduce the program's obligations but rather siphoned off to financing Obama's health care agenda.

Urgent Need for Reform. Medicare should remain as it is today for current beneficiaries. But at a date certain, Medicare should be transformed into a defined-contribution system in which the government contribution for benefits is adjusted for age, income, or health status.

The elements of reform have been discussed for many years and have been advanced by responsible analysts and public officials, including the 1999 National Bipartisan Commission on the Future of Medicare. There is no need to reinvent the wheel.

In implementing reform, the new government contribution should be based on a real market calculation of the price of medical goods and services but capped at a dollar amount each year, just as it is today in the popular and successful Federal Employees Health Benefits Program. While there are a variety of models for such a system, a defined-contribution arrangement would control the growing costs of Medicare, making those costs predictable and sustainable for seniors and taxpayers alike.

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