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Congress Must Not Ignore the Medicare Trustees' Warning

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Congress needs to get serious about Medicare reform. On March 25, the Medicare Trustees[1] issued a Medicare funding warning that triggers presidential and congressional action to reduce Medicare's excessive dependence on general revenues as part of its overall financing.[2] Congress enacted the Medicare "trigger" to call congressional and public attention to the enormous financial challenge the Medicare program faces. As the baby-boomer generation starts retiring and health costs continue to escalate, the Medicare trustees urge decisive congressional action:

> The longer action is delayed, the greater the required adjustments [will be], the larger the burden on future generations, and the more severe the detrimental economic impact on our nation.[3]

The President introduced his Medicare proposal last month in response to the 2007 Medicare funding warning, and the next President will have to propose legislation yet again in 2009. But Congress does not have to play politics with the Medicare program or wait for presidential action. It can take steps this year to transform Medicare from a costly open-ended entitlement program to a defined-contribution program that would maximize cost control and limit taxpayers' exposure to massive tax increases.

The 2008 Trustees Report. The 2008 Medicare Trustees Report notes that Medicare expenditures in 2007 were $432 billion, or 3.2 percent of gross domestic product (GDP).[4] Over the next 75 years—the time frame for long-term actuarial projections—these expenditures are scheduled to rise rapidly, partially in response to an acceleration of baby-boomer retirements, amounting to almost 11 percent of GDP.[5] The trustees also estimate that Medicare's long-term unfunded obligation—the benefits promised but unpaid for—will amount to more than $36 trillion, or roughly two and a half times the size of the entire U.S. economy.[6] In other words, every American household's share of Medicare's unfunded obligation is like a $320,000 IOU.[7]

Medicare Part A—the Hospital Insurance (HI) Trust Fund, or the part of Medicare that pays hospital bills—accounts for $12.4 trillion of Medicare's unfunded obligation.[8] The HI Trust Fund is already spending more in benefits than it gets in revenues. The trustees project that Part A will grow by 7.4 percent on average over the next 10 years and that the HI fund will be insolvent by 2019.[9]

Medicare Parts B and D contribute $15.7 trillion and $7.9 trillion, respectively, to Medicare's unfunded obligation.10 These programs, grouped under the Supplementary Medical Insurance (SMI) Trust Fund, will never become "insolvent." The reason: The government automatically pays the medical bills for these programs each year, drawing down

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general revenues from the Treasury to cover three-quarters of whatever costs these programs incur. But, as the Trustees note, the SMI portion of Medicare will increasingly require a significantly larger amount of general revenues to finance the open-ended demand for medical benefits.

The trustees report that the cost growth of Part B, averaging 9.6 percent during the past five years,[11] is likely to be even higher than current-law projections because estimates do not include the substantial yearly "fix" that Congress routinely makes to stave off the negative consequences of their own Medicare payment system for doctors. Without this annual "fix," and given Congress's stubborn refusal to reform the Medicare physician payment system in any meaningful way, doctors would face massive payment cuts that could jeopardize senior access to physicians' services.[12]

Unlike Medicare Parts A and B, costs for Part D have been lower than projected, largely because of the positive consequences of the intense competition of the consumer-driven delivery of prescription drugs. Nonetheless, Part D costs are still estimated to increase by 11.1 percent through 2017.[13]

Another Medicare Funding Warning. Under the Medicare Modernization Act of 2003 (PL 108-173), Congress enacted a Medicare funding warning. This is a legal mechanism that triggers action by the White House and Congress to address Medicare's large and growing unfunded obligation. If more than 45 percent of Medicare's total costs are projected to come from general revenues as opposed to dedicated revenues (such as payroll taxes and beneficiary premiums) within seven years, then the trustees must make a determination that the program is relying excessively on general revenues. Two consecutive determinations trigger a Medicare funding warning.

In their 2007 report,[14] the Medicare trustees issued their funding warning and thus triggered a presidential submission of remedial legislation for 2008.[15]

With this year's report, the Medicare trigger has been pulled for the second time. As required by law,

1. *2008 Annual Report of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds*, March 25, 2008, at *www.cms.hhs.gov/ReportsTrustFunds/downloads/tr2008.pdf.*
2. For a description of the Medicare "trigger" mechanism, see Robert E. Moffit and Alison Fraser, "Congress Must Pull the Trigger to Contain Medicare Spending," Heritage Foundation *WebMemo* No. 1796, February 4, 2008.
3. Social Security and Medicare Boards of Trustees, "A Message to the Public," A Summary of the 2008 Annual Reports, March 27, 2008, at *www.ssa.gov/OACT/TRSUM/trsummary.html.*
4. *2008 Annual Report of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds.*
5. *Ibid.*
6. *Ibid.*, p. 197.
7. *Ibid.* Estimate based on authors' calculations.
8. *Ibid.*, Table 3B 10, p. 67.
9. Department of Health and Human Services, "Medicare Trustees Report Shows Serious Financial Status of Medicare Program," at *www.hhs.gov/news/press/2008pres/03/20080325a.html.*
10. *2008 Annual Report of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds*, Tables 3C15 and 3C23, pp. 108 and 124.
11. Department of Health and Human Services, "Medicare Trustees Report Shows Serious Financial Status of Medicare Program."
12. For a discussion of the Medicare physician payment mess, see John S. O'Shea, M.D., "The Urgent Need to Reform Medicare's Physician Payment System," Heritage Foundation *Backgrounder* No. 1986, December 5, 2006, at *www.heritage.org/Research/HealthCare/bg1986.cfm.*
13. Department of Health and Human Services, "Medicare Trustees Report Shows Serious Financial Status of Medicare Program."
14. *2007 Annual Report of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds*, at *www.cms.hhs.gov/ReportsTrustFunds/downloads/tr2007.pdf.*

the next President will have to submit legislation to Congress within 15 days of the next presidential budget for expedited consideration in Congress. But Congress should act now. The cost of continued congressional inaction over the next year would, in effect, add approximately $2 trillion to Medicare's already enormous unfunded obligation, thus imposing even greater financial burdens on young working families.[16]

What Congress Should Do. Congress should start getting serious about facing the country's largest fiscal challenge. It can pursue two broad policy objectives that would make short-term changes in the existing Medicare program compatible with long-term reform while also putting into place major structural changes that would accommodate the retirement of the massive baby-boomer generation beginning in 2011. Specifically, Congress should do the following:

- **Make short-term changes compatible with future reform.** This could include applying existing Part B rules for income-related subsidies to Part D, raising the enrollees' share of Part B premiums from 25 percent to 30 percent, restructuring Medicare and Medigap cost-sharing, and establishing a modest co-payment for home health benefits.[17] Congress may also want to consider phasing in a higher age of eligibility for Medicare benefits.
- **Move toward restructuring the Medicare program for the baby-boomer generation.** The Medicare program should remain as it is today for current beneficiaries. But, at a certain date, Medicare should be transformed into a defined-contribution system in which the government contribution for benefits is adjusted for age, income, or health status. In any case, the 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 (FEHBP). While there are a variety of models for such a system, a defined-contribution arrangement would make Medicare costs predictable for seniors and taxpayers alike.

Conclusion. The rapid growth in the cost of federal entitlements is perhaps the single largest domestic policy challenge facing Congress. Whether or not Congress wants to face it, Medicare reform is the most important entitlement policy issue. The costs and consequences of a failure to act in a timely fashion are enormous.

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15. The legislation is entitled the Medicare Funding Warning Response Act of 2008. It has been introduced in the House and Senate as companion bills H.R. 5480 and S. 2662. For a brief description of the act, see *www.hhs.gov/asl/medicarefundingwarningsummary.pdf*.
16. *2008 Annual Report of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds* and authors' calculations.
17. For a more detailed description of these options, see Robert E. Moffit, Ph.D., "Make Medicare Budget Options Compatible with Comprehensive Reform," Heritage Foundation *WebMemo* No. 1807, February 11, 2008, at *www.heritage.org/Research/Budget/wm1807.cfm.*