CBO TESTIMONY

Statement of
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on
The Implications of Medicare Financing
for the Federal Budget

before the
Committee on Finance
United States Senate

May 5, 1999

NOTICE

This statement is not available for public release until it is delivered at 10:00 am (EDT), Wednesday, May 5, 1999.

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Mr. Chairman and Members of the Committee, I am pleased to be here today to discuss the implications of Medicare financing for the federal budget and the U.S. economy. Growth in Medicare spending has slowed remarkably in 1998 and 1999. Spending during the first half of the current fiscal year is actually $2.6 billion less than during the comparable six-month period in 1998. That slowdown is unprecedented and contributes to the favorable near-term outlook for the federal budget, which will accumulate a large and growing surplus.

But the budget is expected to face mounting pressures in the long term from demographic changes and rising health care costs. Left unchecked, those pressures would greatly increase the cost of providing health services under Medicare. The higher costs would ultimately be borne by taxpayers and Medicare beneficiaries.

MEDICARE SPENDING AND THE BUDGET

The Medicare program pays for the health care of 39 million elderly or disabled people in the United States. This year, spending for benefits is expected to top $200 billion. That amount makes Medicare the second largest entitlement program; only Social Security is larger. For many years, Medicare spending has grown substantially faster than both the economy and the spending of other major federal programs. Despite recent slowdowns in that growth, the Congressional Budget Office (CBO)

TABLE 1. MEDICARE BENEFITS, FEDERAL OUTLAYS, AND GDP, 1979-2009 (By fiscal year)

	Billions of Dollars				Average Annual Growth Rate (Percent)		
	1979	1989	1999	2009	1979-1989	1989-1999	1999-2009
Medicare Benefits	28	94	212	443	12.9	8.4	7.6
Total Federal Outlays	504	1,144	1,704	2,344	8.5	4.1	3.2
Gross Domestic Product	2,497	5,356	8,846	13,688	7.9	5.1	4.5
Memorandum:							
Medicare Benefits as a Percentage of Federal Outlays	5.6	8.2	12.4	18.9	n.a.	n.a.	n.a.
Medicare Benefits as a Percentage of GDP	1.1	1.8	2.4	3.2	n.a.	n.a.	n.a.

SOURCE: Congressional Budget Office.

NOTE: n.a. = not applicable.

projects that Medicare spending will continue to increase faster than the resources that finance it.

Spending on Medicare benefits grew at double-digit rates during the 1980s (see Table 1). The share of both the federal budget and gross domestic product (GDP) accounted for by Medicare increased by about half between 1979 and 1989.

That spending slowed somewhat during the early 1990s, rising at an average rate of almost 10 percent a year between 1993 and 1997.

In 1998, however, the growth of Medicare spending slowed sharply. After increasing by more than 8 percent in 1997, outlays for benefits rose by just 1.5 percent in 1998. Medicare spending has actually declined during the first six months of fiscal year 1999, dropping by over 2 percent from the comparable period the year before. Between its January and March baselines, CBO has lowered its projection of program spending for the year by about $6 billion.

The slowdown in Medicare spending that began in 1998 is related to three factors:

- The Balanced Budget Act of 1997 reduced payment rates for many Medicare services and restrained the update factors for payments through 2002,

- Widely publicized efforts to clamp down on fraud and abuse have improved providers' compliance with Medicare's payment rules, and

- The average time for processing Medicare claims rose dramatically in 1998.

Those factors notwithstanding, outlays for benefits are expected to grow by 8.4 percent a year over the next decade. At that rate, Medicare spending will account for almost 20 percent of the federal budget by 2009, up from 12.4 percent in 1999. It will also rise from 2.4 percent of GDP to 3.2 percent.

In spite of rapidly growing outlays for Medicare, CBO projects that the federal budget will accumulate growing surpluses over the next 10 years, assuming that current policies do not change and the economy stays on its projected course. Those large and rising surpluses will reduce the federal debt and the interest costs of servicing it; thus, they will provide a substantial cushion against future expenses.

THE LONG-TERM OUTLOOK FOR THE BUDGET

In future decades, the federal budget will face mounting pressures as the baby-boom generation begins to draw benefits from both Social Security and Medicare. A larger elderly population will also have growing needs for long-term care, resulting in higher Medicaid spending. The substantial financial cushion that resulted from surpluses in the near term will eventually disappear, and hard choices will have to be made about how to allocate the budget between competing programs.

A major factor in the rapid expansion of Medicare and Social Security in coming decades is growth in enrollment. Under the intermediate assumptions of the Social Security trustees, the elderly population will increase by slightly more than 1 percent a year between 2000 and 2010 (when the first baby boomers become eligible for Medicare and Social Security benefits). Between 2010 and 2030, by contrast, the elderly population will grow by almost 3 percent a year, rising from 39 million to 69 million people. Because of increased longevity, the proportion of that population over age 75 will rise as well.

Medicare costs are likely to grow much faster than program enrollment, however. The cost per beneficiary of providing health care services has risen dramatically since the program began in 1965, and it is expected to keep growing rapidly in the future. That growth reflects advances in medical technology that will raise health care costs, as well as continuing increases in beneficiaries' use of services. Medicare has not changed appreciably since its creation and remains largely a fee-for-service program—whereas health care for most of the working population has been converted to some type of managed care (with generally more generous benefits than Medicare's).

If Medicare is not reformed, changing demographics and rising health care costs will place greater demands on both the budget and the economy. Currently, Medicare, Medicaid, and Social Security together account for about one-third of

federal spending and 8 percent of GDP (see Table 2). By 2030, when the last of the baby boomers will have reached age 65, those programs will account for two-thirds of federal spending and 15 percent of GDP, according to CBO's long-term projections, which are based in part on the assumptions of the Medicare trustees. The largest share of that growth is attributable to Medicare, which is projected to increase from 2.5 percent of GDP in calendar year 1998 to 5.6 percent in 2030.

After 2030, rising entitlement costs and interest on the public debt are expected to produce growing budget deficits (under current laws and policies). CBO projects that the deficit will rise from 1 percent of GDP in 2030 to 14 percent in 2060. Debt held by the public, which is projected to fall below zero by 2012, will rise to positive levels after 2030 and reach 100 percent of GDP before 2060.

The projection of Medicare spending, based on the forecasts of the Medicare trustees, assumes that growth in spending per beneficiary will gradually decline to be more in line with growth in hourly earnings, even without a significant policy change. Consequently, after 2020, Medicare spending is expected to grow as a share of GDP only to the extent that Medicare beneficiaries grow as a share of the population. That assumption is probably unrealistic; if spending per beneficiary does not slow, Medicare's share of GDP will be significantly higher than CBO has estimated.

TABLE 2. FEDERAL RECEIPTS AND EXPENDITURES AS A PERCENTAGE OF GDP UNDER CBO'S BASE SCENARIO, 1998-2060 (By calendar year)

	1998	2010	2020	2030	2040	2050	2060
NIPA Receipts	22	21	21	21	21	21	21
NIPA Expenditures							
Federal consumption expenditures	5	4	4	4	4	4	4
Federal transfers, grants, and subsidies							
Social Security	4	5	6	6	6	7	7
Medicare	2	3	5	6	6	6	7
Medicaid	1	2	2	3	3	3	3
Other	5	4	4	4	4	4	4
Net interest	3	a	-1	a	1	4	11
Total	21	18	20	22	24	27	35
NIPA Deficit (-) or Surplus	1	3	1	-1	-3	-6	-14
Debt Held by the Public	44	5	-12	-7	16	53	129
Memorandum:							
Gross Domestic Product (Trillions of dollars)	8.5	14.3	21.1	30.3	43.2	60.6	82.1

SOURCE: Congressional Budget Office.

NOTES: The base scenario assumes that rising deficits affect interest rates and economic growth.

These numbers are based on the 10-year budget projections that CBO published in January 1999 (in *The Economic and Budget Outlook: Fiscal Years 2000-2009*, Table 2-5, p. 43) and on the 1998 assumptions of the Medicare trustees. CBO's projections largely anticipated the trustee's 1999 revisions.

NIPA = national income and product accounts.

a. Less than 0.5 percent.

CONCLUSION

A great deal of uncertainty surrounds budget projections beyond the next few years. For one thing, CBO's baseline projections depend on the 10-year budget outlook. Although that outlook has improved dramatically with the passage of the Balanced Budget Act of 1997 and the robust performance of the economy in recent years, unanticipated increases in federal spending or a weaker-than-expected economy could place greater pressure on the budget than anticipated. In addition, the long-term projections are sensitive to assumptions about the future path of population growth, productivity, interest rates, and health care costs—assumptions whose accuracy will not be clear for many years.

What is clear, however, is that Medicare must prepare for the unprecedented demands that the baby-boom generation will soon impose on it. The nation should expect to devote more of its income to health care in the coming decades. The ability to pay for goods and services, including health care services, grows as the economy grows. Policies that enhance economic growth, even outside the Medicare program, will make it easier to meet the needs of the retired population. Moreover, since the elderly will become an increasingly dominant part of the population, public acceptance of larger federal health spending may also increase. But the trade-offs between health care and other goods and services would be less marked if Medicare was more efficient, so that enrollees' needs were met in the least costly way and

demands for health care reflected the true costs and benefits of that care. Moving toward that goal requires adopting proposals to fundamentally restructure the Medicare program.

Some people have stated the policy options for Medicare succinctly—but, I believe, incompletely—by stating that only two choices exist: raising taxes or cutting benefits. However, at least part of the solution might be found in using medical resources more efficiently. For example, hospitals now use only half of their available beds; shedding some of that excess capacity would help reduce costs. Similarly, estimates suggest that too many physicians, particularly specialists, are currently in practice. The wide variation in practice patterns across the country suggests room for improvement in either health outcomes or costs. The millions of hospitalizations for "ambulatory sensitive conditions" such as diabetes and asthma, which could be prevented with proper care, are clearly a situation in which health could be improved and costs reduced simultaneously.

There are other opportunities to increase the efficiency of the health care system. Rather than belabor the point today, I simply want to state that there may be a "third way" that has the possibility of improving health while reducing costs.