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Why the Democrats' Medicare Plan Won't Work

Congressional Democrats have proposed an alternative to the Republican plan to solve the Medicare financing crisis. The Democrats' plan would reduce the projected increase in spending for Medicare Part A (covering hospitalization expenses) by $89 billion over seven years. They contend that the annual report of the Medicare Board of Trustees and calculations by Medicare actuaries show that this limited reduction will solve the Medicare financing crisis. Unfortunately, this is not true.

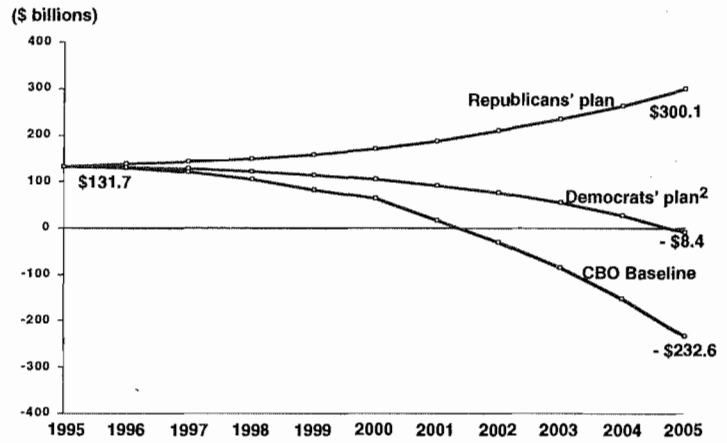
What the Democrats Propose. The Democrats' plan achieves its $89 billion spending reduction primarily by reducing reimbursements to doctors and hospitals. Like the Republican plan, it would allow seniors to choose some private plans in place of Medicare. But it would limit that choice to managed care plans such as HMOs, PPOs and "point of service" plans and would exclude what is likely to be the best option for most seniors: Medical Savings Accounts (MSAs). The Republican plan, by contrast, would allow the elderly to choose from the full range of private sector options.

Failing to Solve the Short-Term Crisis. The Democrats' proposal would be inadequate because it fails to solve the short-term financial crisis facing Medicare.

- Based on the intermediate projections of the Medicare Board of Trustees, the Democrats' plan would delay the bankruptcy of Medicare Part A for only four years — from 2002 to 2006.
- The Congressional Budget Office (CBO) estimates that the plan would delay the bankruptcy date until 2005.

As the figure shows, preliminary CBO estimates indicate that Medicare Part A would be $232 billion in debt by 2005 if nothing is done. The Democrats' plan would also be in the red by that date. The Republicans' plan, by contrast, would be $300 billion in the black — fully able to meet the financial needs of the program for years to come.

Future Financial Status of the Medicare Trust Fund[1] (1995-2005)



[1] Preliminary CBO estimates.
[2] Based on outlay estimates given to the Senate Finance Committee September 25, 1995.

This projection is further supported by other analysts. For example, Guy King, the former chief actuary of the Health Care Financing Administration, who oversaw Medicare projections for the federal government for several years, testified before the House Ways and Means Committee that the Democrats' plan would not meet the test of the Medicare Board of Trustees for short-run financial stability. This test requires the Medicare Part A trust fund to hold assets equal to at least one year's expenditures for each of the next 10 years.

Moreover, the Democrats' plan would keep the Part A trust fund out of the red for the next 10 years only if there are no major recessions. Yet this would be the

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longest period without a recession in U.S. history. Put another way, the Democrats' plan *leaves Medicare vulnerable to collapse if one major recession occurs between now and 2006*. Indeed, the projections assume that real GDP grows by at least 1.9 percent in each of those years.

Failing to Address the Long-Term Crisis. The Democrats' plan completely ignores Medicare's long-term financing crisis. Under the intermediate projections of the Medicare Board of Trustees, paying all current benefits to today's young workers during their retirement would require tripling the current Medicare payroll tax of 2.9 percent of wages. And these projections assume that real wages, which the Democrats say have been falling for 20 years, would grow at 1.0 percent per year for the next 75 years. Under the so-called pessimistic projections, the Trustees' report shows that the Medicare payroll tax would have to increase nearly sixfold, to almost 17 percent of payroll. This would be about one-third larger than the current 12.4 percent payroll tax for Social Security.

Cutting only $89 billion out of the $1.9 trillion that Medicare is projected to spend over the next seven years will not begin to address this long-term financing crisis. The Democrats argue that the Trustees' reports for each of the last 25 years have shown Medicare running out of funds within a five- to 15-year period. The problem has always been deferred by adjusting the program, primarily by cutting payments to doctors and hospitals and raising taxes. However, relying on past experience ignores the long-term gap that is projected to arise after the baby boom generation retires. With this on the horizon, fundamental reforms must begin now.

Cutting only $89 billion will not begin to address the long-term financial crisis.

Failing to Address the Exploding Part B Deficit. Though Democrats concede the need for changes in Medicare Part A, they deny the need for changes in Part B, which covers physicians' fees and certain outpatient services. Financing for the latter is not limited to what can be paid out of the trust fund. The government already pays almost 70 percent of Part B expenditures out of general revenues (with the rest paid by premiums from the elderly). Under current law, the government would continue contributing whatever general revenues are necessary to pay current benefits. So, narrowly construed, there is no issue over whether Part B would run out of funds to pay promised benefits.

Nevertheless, the growth in spending for Medicare Part B must be reduced for the following reasons:

- Part B spending, already almost $70 billion per year, is projected to continue growing at well over 10 percent per year and consequently to double in less than eight years.
- For fiscal 1996, Medicare actuaries project that the Part B deficit will be $62 billion, accounting for almost one-third of the entire federal deficit next year. This Part B deficit is projected to explode to almost $115 billion in fiscal 2002 and almost $150 billion in fiscal 2004 — about $1,500 per year for every American household.

The National Commission on Entitlement Reform, led by Senators Bob Kerrey (D-NE) and (now retired) John Danforth (R-MO), found that in 16 years Social Security, Medicare, Medicaid, interest in the national debt and federal employee retirement will consume *all* federal revenue if they continue as at present. This means that, without any changes in the law, the rest of the federal government will have to be financed by deficit spending.

With a plan that proposes only minimal reductions in Part A spending and no reductions in Part B spending, the only way the Democrats can address the financial problems discussed above is through another massive tax increase.

This Brief Analysis was prepared by NCPA Senior Fellow Peter J. Ferrara.