



# Entitlement Reform Means Fixing the Broader Health System

## Medicare and Medicaid's Budget Challenges

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Discussing long-term budget challenges earlier this year, President Barack Obama remarked, “Social Security, we can solve.... The big problem is Medicare, which is unsustainable.... We can’t solve Medicare in isolation from the broader problems of the health-care system.”

The president is right. Medicare, the entitlement program that provides health coverage for seniors, presents some of the country’s most serious budget challenges. Medicare enrollment, like Social Security, will grow substantially as baby boomers start to become eligible for retirement in 2011. This demographic shift will also strain Medicaid, Medicare’s sister program for low-income families, because much of the program’s budget goes to cover seniors made destitute by the cost of long-term care.

But the far bigger challenge facing both programs is the same one that is making private insurance unaffordable for more and more businesses and individuals: rising health care costs.

Thanks largely to the introduction of new technologies, health care costs have grown an average of 9.8 percent each year—2.5 percentage points faster than the economy as a whole. This cost growth is not only putting health care increasingly out of reach for many Americans; it is a threat to our long-term economic prosperity. The Congressional Budget Office has predicted that unless we take action, health care spending could consume 49 percent of our GDP by 2082, causing wages to stagnate and depressing non-health care sectors of our economy.

Budget hawks in both parties are laying the groundwork to address Medicare and Medicaid’s fiscal problems by limiting spending on these programs. But this “solution” fails to address any of the issues that caused the dramatic increases in health costs in the first place. The vulnerable populations served by these programs are those who will be

least able to find affordable coverage in the private market if federal support is taken away. More fundamentally, trimming entitlements without fixing the broader system does nothing to fix the underlying problem that jeopardizes Americans' access to care and our nation's long-term prosperity.

Overhauling the health care system will be both a political and fiscal challenge, but there is good news: measures such as health information technology, comparative effectiveness research, and payment structures that encourage doctors to prioritize outcomes over volume can save Americans money *and* improve the quality of care delivered.

Some have suggested since the election that budget constraints may force the new president to shelve his plans for health reform. It is clear, however, that addressing our largest budget problems will have to begin with fixing our health care system.

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## What are Medicare and Medicaid?

Medicare and Medicaid are called “entitlements” because the government is legally obligated to cover all those who meet eligibility requirements. Medicare, which was created in 1965, provides health insurance for Americans over 65 and younger Americans with certain disabilities. In addition to covering doctors' visits and hospital fees, Medicare began offering a prescription drug benefit in 2006.

Medicare is partly financed the same way Social Security is—dedicated payroll taxes—which means today's workers are helping pay retirees' costs. These taxes, also like Social Security, go into a trust fund that anticipates some of Medicare's growing costs. The dedicated funding stream accounted for 41 percent of Medicare's \$506.8 billion budget in 2008, with an additional 39 percent allocated by Congress out of general revenues. Coverage is not free to beneficiaries, however. Not only did they pay into the system when they were working; they also pay premiums and co-pays for their benefits. Beneficiaries paid 17 percent of their costs, on average, in 2005.

Medicaid, which provides health coverage for low-income families, is structured very differently. It is administered by state governments, which pay a portion of the program's costs with help from matching contributions from the federal government. (On average, the federal government pays 57 percent of Medicaid costs.) States have a great deal of latitude to determine who is eligible for coverage, though most states generally only make it available to low-income children and their parents. Medicare is especially important to the 10 million Americans who are in need of long-term care, which includes seniors in nursing homes and younger Americans with permanent disabilities who need support to stay in the community.

Unlike Medicare, Medicaid has no dedicated tax. Congress must appropriate its entire budget out of general revenues every year.

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## What is driving cost growth?

Cost growth is driven by multiple factors, but experts widely agree that technology is overwhelmingly responsible. Experts who have tried to quantify its effect estimate that technology is responsible for almost two-thirds of cost growth.<sup>\*</sup> This includes everything from new drugs to advanced diagnostic devices to updated surgical techniques. Millions of lives have been saved and improved through these treatments, but they have not come cheap. And not all new technologies improve outcomes—some are no better, or sometimes even worse, than older treatments, even though they come with much higher price tags.

A report from the Kaiser Family Foundation uses the treatment of heart disease to illustrate how technology has increased costs. Coronary artery bypass surgery became more common during the 1970s. In the '80s, patients were prescribed beta-blockers on a long-term basis and angioplasty became widespread. The '90s brought us implantable defibrillators and stents to unclog arteries.

The mortality rate from heart attack fell by almost half during that 30-year period, from 345.2 per 100,000 people to only 186. And yet a new study from the *New England Journal of Medicine* shows that this same technology could be used more efficiently and effectively. Stents are being used in patients for whom less invasive and cheaper treatments would be more effective. We also know that many new prescription drugs are no better than generics but cost a great deal more.

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## Two problems, one solution

“There is a ray of hope,” Peter Orszag told Congress in his former roles as director of the Congressional Budget Office when describing the strain health entitlements are putting on the federal budget. “We appear to have massive opportunities to reduce health care costs,” easing the financial pressures while making health care accessible to more Americans. Orszag is currently the director of the Office of Management and Budget.

Orszag laid out four areas in which health reform could produce these savings:

- Increasing the use of health information technology and electronic medical records, which is a necessary, but not sufficient, measure to improving the quality and efficiency of the health care system.

\* Mark S. Freeland, Stephen K. Heffler, and Sheila D. Smith, “The Impact of Technological Change on Health Care Cost Increases: A Brief Synthesis of the Literature,” June 1998, Office of the Actuary, Health Care Financing Administration.

- Expanding research on the “comparative effectiveness” of different options for treating a given medical condition, which could provide information on medical benefits as well as costs.
- Offering financial incentives for better care rather than more care—financial incentives for providers and patients currently encourage or facilitate expensive treatment and procedures, even when there is little evidence that they are more effective than existing therapies.
- Providing incentives for prevention (such as immunizations and screening tests) and healthy living (such as avoiding obesity and smoking) so that people have fewer health care problems throughout their lives.

We do not face a choice between our personal health and our government’s fiscal health, nor must we choose between securing health care for our seniors and balancing our budget. The choice we face is to tackle the difficult problem of health reform today or jeopardize our health care system and our long-term prosperity.

### For Further Reading

The Congressional Budget Office, “The Long-Term Outlook for Health Care Spending,” November 2007.

The Kaiser Family Foundation, “How Changes in Medical Technology Affect Health Care Costs,” March 2007.

### Point-Counterpoint

Point	Counterpoint	The Bottom Line
We can’t afford to tackle health reform now while we face a looming budget crisis.	Rising health care costs are driving the growth of the Medicare and Medicaid entitlement programs, which now account for roughly 20 percent of the federal budget.	Rising health care costs are the biggest threat to the federal budget’s long-term health, and fixing the budget begins with reforming the health care system—the whole system.
The easiest solution to the health care entitlement programs’ budget problems is to limit how much the government spends.	The problems facing Medicare and Medicaid are the same ones plaguing the private health care system: rising costs.	Limiting federal health care expenditures does nothing to address the underlying threat that health care costs pose to our economy.
The recession requires government to tighten its belt, and we need to cut health care spending for Medicare and Medicaid.	Elderly and low-income Americans’ need for affordable care does not diminish with an economic downturn.	If elderly and low-income families lose Medicare and Medicaid, they will likely be unable to find affordable care in the private insurance market, which is already in crisis because of rising health care costs.
Health reform is too expensive.	Rising health care costs could cause our entire economy to stagnate.	We cannot afford not to address rising health care costs, and the problem will only get more difficult the longer we wait.

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## In the News

### **“Obama Pledges Entitlement Reform”**

The incoming president shares his views on the need for entitlement reform during a roundtable with editors and reporters of *The Washington Post*.

### **“Health Care Now”**

Nobel-prize winning economist Paul Krugman argues in a *New York Times* op-ed that the economic crisis makes it more urgent than ever for the federal government to take up health reform.

### **“Health care: Reform will restore prosperity”**

Congressman Jim McDermott (D-WA) explains why “our health-care financing structure is directly tied to our employment structure” in the *McClatchy-Tribune*.

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## The Last Word

“The principal driver of our long-term deficits is rising health care costs . . . . Rising costs for Medicare and Medicaid, in turn, reflect rising health care costs across the public and private sectors. Therefore, we need to be thinking about ways to slow overall health care cost growth, rather than just reducing the rate of growth in Medicare and Medicaid.”

–Peter Orszag, Senate Budget Committee testimony before his confirmation as director of the White House Office of Management and Budget, January 13, 2009.