“Making Medicare, Medicaid and Social Security Sustainable for the Long Run”
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Chairman Ryan, Representative Van Hollen, and Members of the Committee:

Thank you for the opportunity to testify before the Committee today at this very important hearing on “Fulfilling the Mission of Health and Retirement Security.” Health and retirement security are essential to the wellbeing of the American population. Decades of congressional actions by both political parties created Medicare, Medicaid and Social Security, which contribute enormously to that security and have very broad public support. Americans are counting on those programs to be there for them when they need them. The biggest challenge facing budget policy makers is to find ways to ensure that the promises represented by these programs are met in ways that are affordable and fiscally sustainable for the long run, as the population ages and health care becomes increasingly expensive.

In the last year and a half, I have had the privilege of serving on the National Commission on Fiscal Responsibility and Reform (the Simpson Bowles Commission). I have also co-chaired, with my friend former Senator Pete Domenici, the Bipartisan Policy Center’s Task Force on Debt Reduction. Both groups concluded that the federal budget is on a dangerously unsustainable path and that we must act decisively soon to reduce the risk of a debt crisis that could severely damage our future prosperity and global influence. Both reports emphasized that spending under Medicare, Medicaid, and to a lesser extent Social Security are projected to rise faster than revenues over the next several decades, creating unsustainable increases in deficits and debt. Both reports proposed reforms in these three programs, but both concluded that all parts of the budget (including domestic and defense appropriations, other mandatory spending, tax expenditures and revenues) must also play a part in reducing future deficits and restraining the growth of debt. In the interests of time and clarity, I will talk today about the recommendations of the Domenici-Rivlin Task Force with respect to Medicare, Medicaid and Social Security.

Medicare

Rapid increases in health care spending—due to ever-expanding medical capabilities and rising demand by an aging population combined with an inefficient delivery system--are already straining the federal budget. Indeed, they are straining all budgets, including those of states, localities, businesses and families. A common health care delivery system

*The views expressed are those of the author and are not attributable to the institutions with which she is associated.

serves both Medicare beneficiaries and those with private insurance. Hence, the challenge of Medicare reform is to restrain the growth of this large federal spending program in ways that help the whole health care system deliver care more efficiently and effectively—and to do this without shifting the costs of caring for Medicare beneficiaries to other payers or causing providers to drop out of Medicare.

Medicare is still largely a fee-for-service (FFS) system, in which the government is obligated to pay the bills presented for specified services to eligible beneficiaries. There are few incentives built into the system for providers to deliver care efficiently or effectively, costs vary widely from one provider or area to another, and the government has no way to restrain the total cost of the program. There are major opportunities both to slow the growth of Medicare spending and for the program to provide leadership in improving health service delivery.

The Affordable Care Act includes important provisions aimed at improving health outcomes and reducing cost growth: authorizing Medicare to contract with accountable care organizations on the basis of shared savings and value-based payments to providers; pilot projects to try out other payment reforms; research on effectiveness of treatments; and development of information technology. However, the impact and timing of these efforts is still uncertain. Therefore, the Task Force recommended several cost-saving reforms in the short run followed by a gradual transition of Medicare to a "premium support" or defined contribution program, which would incent efficient delivery while controlling the rate of growth of total Medicare costs.

For the short-term, the Task Force proposed these measures:

- Gradually raise Medicare Part B premiums from 25 to 35 percent of total program costs (over five years);
- Use Medicare's buying power to increase rebates from pharmaceutical companies;
- Modernize Medicare's benefits package, including the copayment structure; and
- Bundle Medicare's payments for post-acute care in order to increase incentives for efficiency and cost reduction.

Beginning 2018 Medicare beneficiaries would have a choice of remaining in FFS Medicare or going to a Medicare Exchange, where they could choose among competing private health plans. The health plan would receive a fixed payment, risk-adjusted for the age and health status of the beneficiary and would not be able to cherry pick the least costly beneficiaries. In the first year, the subsidy for those choosing the exchange would be equal to the average subsidy for traditional FFS Medicare. In subsequent years, the growth in the subsidy for both options would be limited to growth of GDP (five-year average) plus one percent. This is lower than the baseline projection of GDP plus 1.7 percentage points. If the cost of FFS Medicare rises faster than GDP plus one percent, those electing to stay in that system would have to pay a premium to cover the additional cost.

There are two reasons for shifting to a premium support model for Medicare. One is that the total subsidy would be controllable. Taxpayers would be making a defined contribution. Congress could, of course, vote to increase the subsidy faster than GDP growth plus one percent, but the budgetary consequences of doing so would be explicit. The other reason is that competition on a well managed exchange can be expected to attract beneficiaries to health plans that organize themselves to provide the most effective care at the lowest price. The Medicare Exchange would be charged with providing the beneficiary with clear, customer friendly information about each plan's benefits, cost and health outcomes.

Chairman Ryan and I drafted a skeletal version of Medicare Premium Support for consideration by the Simpson-Bowles Commission. The Ryan-Rivlin version would phase in much slower than Domenici-Rivlin, because it would affect only newly eligible Medicare beneficiaries beginning in 2021. This version would not offer premium support to those already in Medicare (although it would presumably retain Medicare Advantage) and would not retain FFS Medicare as an option for new enrollees . Hence, the transition would take much longer than the Domenici-Rivlin version.

While the proposed premium support model resembles the current structure of Medicare Advantage, there are important differences. Competition among plans would be enhanced by creating a federal Medicare Exchange, which would increase the competitiveness of the market, leading to lower premiums. While Medicare currently informs beneficiaries of available Medicare Advantage plan choices and plan performance through a web site and other means, one-on-one marketing by Medicare's private plans is a dominant model for enrollment. A more formal exchange could make it easier for beneficiaries to compare and select among the plans available to them in head-to-head comparisons, reduce sales and marketing costs of the plans, and create better value for enrollees. Improvements will also emerge as states develop exchanges for individuals and small employers under the Affordable Care Act. The proposed Medicare Exchange would also provide incentives for plans to develop products that will save beneficiaries money. Today, if a Medicare Advantage plan has very low costs, it cannot pay a rebate to enrollees; instead, it must increase benefits. Under the proposed Medicare Exchange plans could offer beneficiaries relief from rising Medicare premiums, creating additional market incentives for efficiency.

Asking beneficiaries to pay more for their Medicare coverage (or shift to a lower-cost plan) mirrors what has happened in private insurance over the past decade, with increases in patient cost sharing to keep premium growth from exceeding income growth by too large a margin. Employers have generally opted to increase patient cost sharing rather than increase the percentage of the premium that employees contribute. The former keeps employees enrolled in the plan and encourages more judicious use of health services.

Medicaid Reforms

Medicaid, the program that provides health coverage to millions of low-income

Americans, poses a different set of challenges because it is jointly funded by the federal and state governments, but administered by each state.

In order to control Medicaid costs in the short term, the Task force recommended removing barriers that states face in providing benefits to “dual eligibles” (those eligible for both Medicare and Medicaid) through managed care plans. For the longer run the Task Force offered several approaches to reducing the amount by which Medicaid is growing faster than the economy. The goal would be to reduce annual per-beneficiary cost growth by 1 percentage point.

One approach to achieving these savings would be to discontinue the shared financing arrangement between the federal and state governments. The system of matching federal payments that is currently in place has led to “gaming” of the system, where *states* have an incentive to run up higher health care costs in order to get more federal matching payments. At the same time, the *federal government* doesn’t bear the full cost when it chooses to expand Medicaid benefits. The Task Force proposes to end these perverse incentives by *allocating program responsibilities between the federal government and the states* – in a budget neutral manner – so that each level of government would fully finance and administer its assigned components of the Medicaid program. This would require a complex set of negotiations between the federal and state governments but, in the end, would restore incentives for cost containment, and slow future growth.

There are other approaches to slowing the growth of Medicaid spending while continuing to provide adequate health care for the low income population. States could be given more leeway to design their own programs, either through block grants (with maintenance of effort requirements) or through waivers under the existing program. Ultimately, when the state health care exchanges created by the Affordable Care Act are running well, Medicaid beneficiaries could be transitioned to the exchanges.

Cap and Phase Out the Employer Provided Health Insurance Exclusion

The Task Force plan includes an essential third component to reining in rapidly rising health care costs. As you know, the tax code currently excludes from income, health insurance benefits provided by employers. Our Task Force proposes to *cap the exclusion of employer-provided health benefits in 2018, and then phase it out over 10 years.* There is broad agreement among health care economists that this will incent employers and employees to select more cost-effective health plans. In addition, because this is the largest tax expenditure in the federal budget, its phase-out will reduce the federal debt by an appreciable amount. Moreover, it will strengthen Social Security by increasing payroll revenues to the Social Security Trust Funds.

Federal spending on health care and loss of revenue through the exclusion is so large that addressing it is critical to success of efforts to reduce the deficit enough to control federal debt. Large federal deficit reductions in health will require policies that slow the rate of growth of spending overall. Changing the tax treatment of employer-based health insurance and Medicare premium support are two steps that the Task Force considers to have the largest long term potential. But slowing the rate of growth of health spending is so challenging that many other policies should be pursued as well.

Social Security

Finally, we must address Social Security and do it soon. Social Security, while separately funded by payroll taxes, is *not* in sound fiscal shape for the long run. Since putting Social Security back on a firm foundation will make only a modest contribution to reducing long run deficits, deficit reduction is not the central motivation for fixing Social Security. The right reason for saving Social Security is to reassure all Americans that this hugely successful program is solidly funded and will be there for the millions who depend on it when they need it. The main reason for acting *now* rather than later is simply that the sooner we act the less drastic adjustments we have to make. These adjustments can involve revenue increases, future benefit reductions (with or without retirement age changes), or some of each. They need not be large if they are done quickly and they need not have a significant effect on those currently retired or close to retirement.

Those who argue that Social Security should not be part of a deficit reduction plan, sometimes point out that Social Security has been running surpluses for decades. Those surpluses were invested in Treasury bonds, which meant the government was borrowing from Social Security to fund other spending. Now that the time has come to redeem those bonds, they say, Social Security should not be "punished" by having to share in the reduction of future deficits. But this reasoning misses the point. Putting Social Security on a sound fiscal footing is not "punishing" the system or its beneficiaries. The bonds held by Social Security are obligations of the United States and will be paid—even though Treasury will have to borrow to pay them. But current and future workers need to know that Social Security will be there for them, and the best way to reassure them is to act now to adjust future benefits and revenues. Taking immediate action is the right thing to do for future Social Security beneficiaries. That such action will also modestly reduce long run deficits and show the world that our political system is not totally gridlocked is just icing on the cake.

The President's Fiscal Commission and our Debt Reduction Task Force both produced viable, solid plans to strengthen Social Security and ensure its long-term solvency. The Task Force plan would:

- Gradually raise the amount of wages subject to payroll taxes (currently $106,800) over the next 38 years to reach the 1977 target of covering 90 percent of all wages;
- Change the calculation of annual cost-of-living adjustments (COLAs) for benefits to more accurately reflect inflation (this technical change is proposed for all COLA adjustments in the budget, including the indexation of tax brackets);
- Slightly reduce the growth in benefits compared to current law for approximately the top 25 percent of beneficiaries;
- Beginning in 2023, index the benefit formula for increases in life expectancy, *without changing either the age of full retirement or the early retirement age* from

those in current law and require the Social Security Administration to ensure that early retirees understand that they are opting for a lower monthly benefit.

- Increase the minimum benefit for long-term, lower-wage earners, and protect the most vulnerable elderly with a modest benefit increase.
- Cover newly hired state and local government workers under the Social Security system, beginning in 2020, to increase the universality of the program.

Mr. Chairman and Members of the Committee, I want to thank you for the opportunity to discuss today the great importance of addressing entitlement reforms as soon as possible. Let me say in closing that they should be addressed in the context of a full and balanced debt reduction plan that also includes a multi-year freeze on defense and non-defense discretionary spending, and a reform of the tax code that raises more revenues but also dramatically simplifies the tax system and makes our tax laws more competitive and pro-growth.

I urge you to be bold in developing your FY 2012 Budget Resolution and I am happy to assist in any way I can. I would be happy to answer your questions.