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If Medicare Cuts Proposed in Baucus Plan Are To Be Believed, Long-Term Deficit Outlook Is Favorable

Over Twenty Years, Baucus Plan Is Deficit-Neutral Even Without Excise Tax on "Cadillac" Health Insurance Plans

By Gerald Prante

Introduction

Passage by the Finance Committee yesterday of Chairman Max Baucus's health care proposal came after receiving a boost from the Congressional Budget Office, which analyzed the plan and reported that it would be deficit-neutral over ten years with $81 billion to spare.

One feature of the CBO report is its estimate of "savings," i.e., cuts in current health spending, mostly Medicare. The cuts are far more substantial than some may have expected, and they might constitute a hurdle in themselves to future bills.

Cuts in Medicare and other health programs ratchet up quickly in the CBO score, reaching $93 billion in 2019 alone and totaling $404 billion between FY 2010 and 2019. Assuming those Medicare cuts continue growing at the same rate after 2019, they could reach a total of $1.8 trillion over the next ten-year period, 2020–2029.

In other words, if Congress were considering a 20-year budget window instead of ten years, Chairman Baucus's proposed excise tax on Cadillac health plans would not be necessary to pay for the plan. Even without those revenues, the spending cuts would probably be sufficient to cut the deficit. (The other smaller tax hikes and revenue raisers would remain.)

Near-Term Critique

Some critics question the validity of the deficit-neutral finding over the ten-year budget window. Their doubts center around the timing of Chairman Baucus's various provisions. His new taxes and spending cuts are scheduled to kick in years earlier than the new health benefits. And indeed, over the ten-year budget window that the CBO is obliged to use (FY 2009–2019), the three-year disparity between the onset of tax collections and spending cuts (immediate) and new health benefits (three-year delay) is a bit of an apples-to-oranges comparison and does improve the plan's score on the deficit.

However, as we explained here, if one compares apples to apples by scoring the Baucus plan over the subsequent ten-year period, between 2020 and 2029, the spending cuts in Medicare combined with the proposed tax hikes far exceed the cost of new health benefits for working-age people, improving the deficit dramatically. In short, if the Medicare cuts in the Baucus plan are politically sustainable, their likely impact in the long term would be to lower budget deficits.

Year by Year Analysis Over 20 Years

Here, we classify CBO's scoring of the Baucus plan into four general categories:

- Gross Cost of Additional Health Insurance Coverage
- Excise Tax on Cadillac Health Insurance Plans
- Other Taxes and Revenue Effects
- Savings accruing from reductions in outlays for Medicare, Medicaid and other health care spending

The First Ten-Year Budget Window (2010-2019)

CBO arrives at the $81 billion deficit reduction figure by first measuring the cost of coverage expansion within the bill, namely higher spending on Medicaid and subsidies for health insurance exchanges. This cost alone is $829 billion over the ten-year window (2010–2019) and is $180 billion in the final year of that window (2019).

Each of the other three CBO categories provides financing for the cost of those expanded health benefits. First, the proposed excise tax on high-valued health insurance plans – so-called Cadillac plans – is estimated to raise $201 billion in revenues from 2010-2019. Then, there are other taxes and revenue raisers in the package that would total approximately $305 billion in the ten-year window. Finally, CBO estimates that the Baucus plan will achieve large savings by reducing outlays for Medicare, Medicaid and other health care spending, spending reductions that would save the federal government approximately $404 billion over the ten-year window.

Table 1 below shows the effects of the health care bill for each of the years of the current ten-year window (2010-2019). As one can see, the Baucus plan would actually lower the deficit in FY 2019, hinting that out years would likely be the same as we discuss below.

Table 1 Net Effect on Deficit from Baucus Plan over 2010-2019 Budget Window, CBO Score (billions of dollars)											
CBO Category	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	10-yr
Gross Cost of Insurance Coverage	$ 0	$ 2	$ 4	$ 8	$ 56	$ 115	$ 143	$ 155	$ 166	$ 180	$ 829
Excise Tax – "Cadillac"	$ 0	$ 0	$ 0	–$ 10	–$ 18	–$ 23	–$ 30	–$ 35	–$ 40	–$ 46	–$ 201
Other Tax & Revenue Raisers	–$ 11	–$ 12	–$ 13	–$ 25	–$ 29	–$ 35	–$ 39	–$ 42	–$ 47	–$ 52	–$ 305
Spending Reductions	$ 9	–$ 1	–$ 11	–$ 21	–$ 42	–$ 47	–$ 55	–$ 66	–$ 78	–$ 93	–$ 404
Net Amount	–$ 2	–$ 11	–$ 20	–$ 47	–$ 32	$ 10	$ 20	$ 13	$ 1	–$ 12	–$ 81

The Next Ten-Year Budget Window (2020-2029)

The $404 billion savings that would accrue from Chairman Baucus's proposed cuts to Medicare and other health care programs during the first 10 years are projected by CBO to grow at a rapid rate in the latter years of this budget window. For example, from 2018 to 2019, CBO projects the savings from cutting Medicare and other health care spending that are in Chairman Baucus's plan would increase by nearly 19 percent. This high annual rate makes sense to anyone who has analyzed Medicare's long-run fiscal situation: the huge number of Baby Boomers coming into the system in the next decade is projected to make Medicare spending grow rapidly. Therefore, curtailing those benefits now will result in huge savings down the road. When CBO discussed the likely rate of growth in this category beyond the first ten years, it suggested a range of 10-15 percent, which seems quite conservative, based upon the annual growth rates in the out-years of the current ten-year window.

Regardless of whether we assume the more conservative CBO out-year growth rates or merely extend the 2019 growth rate, it is clear that the Baucus plan would not grow the deficit beyond 2019. Tables 2-4 look at some likely scenarios of the Baucus plan's likely budget impact during the ten years after the current budget window (FY 2020–2029). All these scenarios assume that the Baucus plan actually remains fairly close to the version that was scored by CBO.

Table 2 Net Effect on Deficit from Baucus Plan over 2020-2029 Budget Window, Extending CBO Figures Using CBO's Mid-Range Growth Estimate (billions of dollars)											
CBO Category	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	10-yr (20-yr)
Gross Cost of Ins. Coverage	$194	$210	$227	$245	$264	$286	$308	$333	$360	$389	$2,816 (–$3,645)
Excise Tax - Cadillac	–$52	–$58	–$65	–$74	–$83	–$93	–$105	–$118	–$133	–$149	–$930 (–$1,131)
Other Tax & Rev. Raisers	–$57	–$63	–$69	–$76	–$84	–$92	–$101	–$111	–$123	–$135	–$912 (–$1,217)
Spending Reductions	–$105	–$118	–$132	–$149	–$168	–$189	–$212	–$239	–$268	–$302	–$1,881 (–2,285)
Net Amount	–$19	–$29	–$40	–$54	–$70	–$88	–$110	–$135	–$164	–$198	–$907 (–$988)
Growth rates assumed: Insurance Coverage growth rate = 8%; Excise Tax growth rate = 12.5%; other tax & revenue growth rate = 10% ; Spending reductions growth rate = 12.5%%											

Table 3
Net Effect on Deficit from Baucus Plan over 2020-2029 Budget Window, Extending CBO Figures Using CBO's High-End Growth Rate
(billions of dollars)

CBO Category	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	10-yr (20-yr)
Gross Cost of Insurance Coverage	$194	$210	$227	$245	$264	$286	$308	$333	$360	$389	$2,816 (–$3,645)
Excise Tax - Cadillac	–$53	–$61	–$70	–$80	–$93	–$106	–$122	–$141	–$162	–$186	–$1,074 (–$1,275)
Other Tax & Revenue Raisers	–$57	–$63	–$69	–$76	–$84	–$92	–$101	–$111	–$123	–$135	–$912 (–$1,217)
Spending Reductions	–$107	–$123	–$141	–$163	–$187	–$215	–$247	–$284	–$327	–$376	–$2,171 (–$2,575)
Net Amount	–$23	–$37	–$54	–$74	–$99	–$128	–$163	–$204	–$252	–$309	–$1,341 (–$1,422)

Growth rates assumed: Insurance Coverage growth rate = 8%; Excise Tax growth rate = 15%; other tax & revenue growth rate = 10%; Spending reductions growth rate = 15%

Table 4
Net Effect on Deficit from Baucus Plan over 2020-2029 Budget Window, Extending CBO Figures Using 2019 Growth Rate
(billions of dollars)

CBO Category	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	10-yr (20-yr)
Gross Cost of Insurance Coverage	$194	$210	$227	$245	$264	$286	$308	$333	$360	$389	$2,816 ($3,645)
Excise Tax – "Cadillac"	–$53	–$61	–$70	–$80	–$93	–$106	–$122	–$141	–$162	–$186	–$1,074 (–$1,275)
Other Tax & Revenue Raisers	–$57	–$63	–$69	–$76	–$84	–$92	–$101	–$111	–$123	–$135	–$912 (–$1,217)
Spending Reductions	–$111	–$132	–$157	–$186	–$222	–$264	–$314	–$374	–$445	–$530	–$2,735 (–$3,139)
Net Amount	–$26	–$46	–$69	–$98	–$134	–$177	–$229	–$293	–$370	–$462	–$1,904 (–$1,985)

Growth rates assumed: Insurance Coverage growth rate = 8%; Excise Tax growth rate = 15%; other tax & revenue growth rate = 10%; Spending reductions growth rate = 19.1%

In short, if the Baucus plan were scored by CBO over 20 years instead of ten, it's likely that Sen. Baucus wouldn't even need to put in place the excise tax on Cadillac health plans in order for it to be deficit-neutral.

Table 4 shows what the budgetary impact would be by merely extending the 2019 growth rates into the next ten years. The spending reductions to Medicare and other health care programs are so massive that government spending, on net, would actually not change much from Chairman Baucus's proposal.

What Are The Cuts to Medicare and Other Health Care Spending in Baucus Plan?

The CBO report details each of the reductions in spending items that Sen. Baucus's plan would implement. According to the CBO report, the bulk of the savings would accrue from three key provisions:

(1) Permanent reductions in the annual updates to Medicare's payment rates for most services in the fee-for-service sector (other than physicians' services), yielding budgetary savings of $162 billion over 10 years. (That calculation excludes interactions between those provisions and others—namely, the effects of those changes on payments to Medicare Advantage plans and collections of Part B premiums.)

(2) Setting payment rates in the Medicare Advantage program on the basis of the average of the bids submitted by Medicare Advantage plans in each market, yielding savings of an estimated $117 billion (before interactions) over the 2010–2019 period.

(3) Reducing Medicare and Medicaid payments to hospitals that serve a large number of low-income patients, known as disproportionate share (DSH) hospitals, by almost $45 billion—composed of roughly $22 billion each from Medicaid and Medicare DSH payments.

The obvious economic question then for policymakers to answer is, "Who bears the economic burden from these spending cuts?" Would lower payment rates to Medicare providers hurt Medicare beneficiaries, or are the providers currently earning economic "rents" (above-market profits) that would disappear under this proposal? The answer is likely somewhere in between, meaning that some fraction of the spending cuts would be borne by the recipients of Medicare, i.e., the elderly, and some other fraction borne by the factors of production in the medical sector, i.e., owners of the firms and labor such as doctors. Unfortunately, nobody seems to be addressing this crucial question. One side says that firms are earning excess profits from government payments in health care. The other side tries to scare seniors by saying that the quality of Medicare will be cut. The truth lies somewhere in between. And as we show here, whoever bears that burden during the first ten-year budget window will bear a much larger burden during the next ten years.

Summary

Critics have charged that the CBO scoring of Sen. Baucus's proposal is somewhat misleading, given that the ten-year budget window includes 10 years of new tax collections and spending cuts, but only seven years of substantial new government-provided health insurance. As this analysis has shown, however, the larger point of this critique – that the Baucus plan is likely to throw the federal government's out-of-balance books even further out of balance – is unlikely to prove true.

The long-term impact of Sen. Baucus's proposal (beyond the current ten-year budget window) would be to cut Medicare spending so significantly that budget deficits would fall substantially. The reason the benefit cuts achieve such remarkable savings is that they come at a time when Medicare spending is projected to skyrocket with the retirement of the baby-boom generation. CBO's projected savings, then, would dwarf any realistic assumption about the increased expenditures that are necessary to pay for the proposed government-led changes in insurance coverage.