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HOUSE SCHIP LEGISLATION WOULD REPEAL DUBIOUS "45-PERCENT THRESHOLD" PROVISION

by Robert Greenstein and James Horney

Legislation to extend the State Children's Health Insurance Program and make various changes in Medicare, which the House is scheduled to consider this week, would repeal a so-called "45-Percent Threshold" provision affecting Medicare that was slipped into the 2003 Medicare prescription drug bill. Some lawmakers argue that this provision is needed to address the serious long-term financing problems Medicare faces.

The 45-percent threshold, however, is an ideologically laden measure that is based on a misleading measure of Medicare's financial health; it is designed to take certain options for improving Medicare financing *off the table*. As a result, the 45-percent threshold could make it harder to address the Medicare's financing problems in an equitable manner, rather than easier. Repealing the 45-percent threshold provision would actually be a positive step; repeal would remove a misguided measure that makes it more difficult to have an informed debate on Medicare's financing problems and that establishes the wrong goal to aim for in restoring Medicare's financial health. Removal of the 45-percent threshold consequently should increase the potential for Medicare reform legislation that is effective and equitable to be considered in the future.

Under the provision of law the House SCHIP legislation would repeal, the Medicare trustees are required to estimate in their annual report on the program's financial status whether general-fund revenues will pay for more than 45 percent of total Medicare expenditures in any of the next six years. The law requires that if two consecutive trustees' reports estimate that the 45-percent threshold will be exceeded within the next six years, a "Medicare Funding Warning" must be issued, and the President must submit,

KEY FINDINGS

- The SCHIP-Medicare bill before the House would repeal the requirement that the President submit next year (and in succeeding years), and that Congress consider, proposals to keep general revenues from making up more than 45 percent of total Medicare funding.
- The 45-percent threshold is a misleading measure of Medicare's financial health. Medicare was designed to be financed in large part by general revenues (as well as payroll taxes), in part because payroll taxes are regressive.
- The effect of the threshold is to take certain options for improving Medicare financing off the table. For example, it prevents Congress from eliminating a modest share of Medicare's funding gap by closing abusive corporate tax shelters or scaling back the tax cuts for the wealthiest Americans. Reform options would be limited to increases in regressive payroll taxes and beneficiary premiums, as well as cuts in benefits and payments to health care providers.
- Medicare's financing problems are large enough that a combination of measures, including added general revenues as well as reforms in Medicare, are likely to be needed.

and Congress must consider, proposals to prevent the 45-percent threshold from being reached.[1]

This year's Trustees' report contained a projection that the threshold will be exceeded in six years (in 2013). Since last year's report also projected the threshold would be exceeded in six years (in 2012), the so-called "trigger" was pulled, and a "Medicare Funding Warning" was issued. When the President submits his budget next February, he will have to submit proposals for changes in Medicare that would prevent the threshold from being exceeded. Congress is required to consider these proposals (although the law does not require Congress to take final action on them).

Unfortunately, the 45-percent threshold misdefines the basic challenge facing Medicare — which is how *much* the program is projected to cost and whether its cost fits within the overall U.S. budget, not what *share* of Medicare's cost comes from any given revenue source. Medicare was specifically designed to be financed in substantial part by general revenues rather than payroll taxes, in part because the latter are regressive. Payroll taxes fund *only* the hospital insurance part of Medicare (Medicare Part A). The physicians' insurance and outpatient services part of Medicare (Part B) and the new prescription drug benefit (Part D) are both funded by general revenues. That more than 45 percent of Medicare financing may come from general revenues poses no more of a problem by itself than the fact that *100 percent* of the financing for defense, veterans' benefits, education, health research, or most other federal programs is financed from general revenues.

The share of Medicare costs that is financed by general revenues is rising for several reasons. Medicare costs have been growing faster than the economy for some time and are projected to continue doing so, largely because of rising costs throughout the entire U.S. health care system, both public and private. For 30 years, the increase in Medicare costs per beneficiary has tracked the increase in private-sector health care costs. (The aging of the population is also raising Medicare costs.) Payroll taxes, in contrast, tend to grow somewhat *more slowly* than the economy. As a result, the share of total Medicare spending that is covered by payroll taxes has been falling, while the share covered by general revenues has been increasing. This trend is expected to continue indefinitely.

Moreover, Congress accelerated Medicare's growing reliance on general revenues when it decided to fund the new Medicare prescription drug benefit with general revenues (and beneficiary premiums) rather than with additional payroll taxes. For these reasons, the 45-percent threshold will be reached in the near future, even if Medicare costs turn out to rise much more slowly than is currently projected.

The biggest problem with the 45-percent threshold is that it impedes action to improve the long-term outlook for Medicare. The financing problems that Medicare faces are sufficiently large that a number of steps will have to be taken. There will be no single silver bullet here, and all options need to be on the table. Changes in the nation's overall health care system, reforms in Medicare itself, and additional general revenues *all* will almost certainly be needed. Marilyn Moon, a former Social Security and Medicare trustee who is widely regarded as one of the nation's leading Medicare experts, has observed that we "probably cannot . . . keep a viable Medicare program without tax increases at some point in the future."[2]

[1] For more details on this provision see Robert Greenstein *et al.*, "Trustees' Report Focuses Attention on Misguided Medicare '45-Percent Trigger,' " Center on Budget and Policy Priorities, revised May 1, 2006.
[2] Statements by Marilyn Moon come from presentations and comments by Moon in two audio-conferences sponsored by the Center on Budget and Policy Priorities on March 23, 2004. Transcriptions are available from the Center.

Yet as Moon has pointed out, the 45-percent threshold "limits the options you have to finding a solution" to Medicare's financing problems.[3] It would effectively rule out an increase in progressive income taxes as a part of a long-term solution for Medicare, since an increase in general revenues would conflict with keeping the general-fund share of Medicare financing from rising above 45 percent. Thus, Congress would be barred from closing a modest share of Medicare's funding gap by scaling back the $160,000 average annual tax cut enacted in 2001 and 2003 for people with incomes of more than $1 million a year, closing abusive corporate tax shelters, or curbing tax avoidance and using such measures, in combination with changes in Medicare itself, to shore up the program's finances.

In contrast, Congress would be permitted to raise regressive payroll taxes, hike the monthly premiums that beneficiaries are charged, and cut the health services that Medicare covers, as well as cut reimbursements to providers. As a result, the 45-percent threshold, if adhered to, would likely exacerbate income inequality that already is at its highest levels in decades.

In short, the 45-percent threshold represent an ideologically driven approach to Medicare's financing woes that provides unseemly protection to the nation's most affluent residents and corporations, at the expense of Medicare beneficiaries and working families of more modest means. Efforts to shore up Medicare should focus on the real problems facing Medicare, not on a dubious 45-percent threshold that is devoid of analytic merit and that, if followed, could impede efforts to address Medicare's problems by taking legitimate financing options off the table.

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[3] Ibid.