CONGRESSIONAL BUDGET OFFICE
U.S. Congress
Washington, DC 20515

Douglas W. Elmendorf, Director

March 27, 2009

Honorable Henry A. Waxman
Chairman
Committee on Energy and Commerce
U.S. House of Representatives
Washington, DC 20515

Dear Mr. Chairman:

This letter responds to your request for an assessment of the potential effects of the substantial across-the-board reductions in Medicare's payment rates for physicians that are called for under current law. The Congressional Budget Office (CBO) estimates that, without legislative action, physician payment rates under Medicare will be reduced by about 21 percent in January 2010 and by about 6 percent annually for at least several years thereafter. By 2014, the cumulative reduction in the rates will be about 40 percent.

The effects of such a large reduction in payment rates on physicians' participation in Medicare, beneficiaries' access to care, and Medicare expenditures are highly uncertain. Previous studies have examined the effects of smaller or more targeted changes in payment rates, but those studies are of limited relevance for assessing the potential effects of the substantial fee reductions that are required under current law. Because of the uncertainty about those effects and the limited applicability of previous studies, CBO supplemented its analysis by consulting with a number of experts in the field of health care to obtain their views.

The effects of the fee reductions could manifest themselves in several ways: by affecting spending on physicians' services directly; by changing the use of other services covered by the traditional Medicare program; or by altering the share of enrollees who get all of their Medicare benefits through a private health plan. Some of those effects could result in costs that are lower than those projected in CBO's baseline, and some could yield higher costs. Because of the uncertainty about the size of those effects and whether, on balance, they would lead to more or less federal spending, there is no basis at this time for concluding that CBO's baseline projections of Medicare expenditures under current law are too high or too low.

Spending on Physicians' Services

At present, nearly all physicians participate in Medicare and accept at least some new Medicare patients, and surveys have found that beneficiaries do not face significant difficulties in obtaining access to physicians' services.[1] Medicare has been able to

[1] Medicare Payment Advisory Commission, *Report to the Congress: Medicare Payment Policy* (March 2009).

maintain good access to those services for its beneficiaries even though the program's physician payment rates in recent years have averaged about 80 percent of the rates paid by private insurers. Faced with a 40 percent cumulative reduction in those payment rates, however, physicians could respond in a number of ways. Some physicians would probably stop accepting new Medicare patients or stop participating in the program altogether. Others would continue to participate in the program and seek to limit the effect of the fee reductions by increasing the volume or intensity of the services they provided; but given the magnitude of the decline in payment rates, they might be able to offset a smaller share of those fee reductions than has been observed in the past.

Effects on Physicians' Participation in Medicare. There is considerable uncertainty about how much a 40 percent reduction in payment rates would lower physicians' participation in Medicare and what that would imply for beneficiaries' access to care and Medicare expenditures. The reduction in physicians' participation would likely vary by specialty and depend on the characteristics of local markets—particularly the number of privately insured patients relative to the number of physicians. Primary care physicians would probably be especially likely to withdraw from Medicare, since large numbers of privately insured patients seek their services in many geographic areas. Moreover, primary care physicians generally have less ability than specialists to compensate for reduced fees by increasing the number of procedures and tests they perform. Over a long period of time, the number of practicing physicians would probably be lower than otherwise.

The Medicaid program may provide a useful reference point. A 40 percent reduction in Medicare's payment rates would result in rates that, on average, are lower than Medicaid's rates.[2] Low payment rates in Medicaid have contributed to less participation by physicians in that program than in Medicare. According to one study, about a fifth of physicians nationwide were not accepting any new Medicaid patients in 2005, compared with only 3 percent who were not accepting any new Medicare patients.[3] The study found that the share of physicians accepting all new Medicaid patients was also lower than for Medicare, and that the treatment of Medicaid patients has become more concentrated among a minority of physicians who practice in large groups, community health centers, hospital clinics, and academic medical centers.

A significant reduction in physicians' participation in Medicare would reduce beneficiaries' access to services; for example, some beneficiaries would have more trouble finding a physician who accepted Medicare, some would have to travel longer distances to see a physician, and some would experience longer wait times for appointments. Such reductions in access would probably reduce beneficiaries' use of physicians' services and Medicare spending on those services. Those effects would vary

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[2] Medicaid's physician payment rates vary widely among states. According to one study, Medicaid's payment rates in 2003 were an average of 69 percent of Medicare's rates. See Stephen Zuckerman and others, "Changes in Medicaid Physician Fees, 1998-2003: Implications for Physician Participation." *Health Affairs*, Web Exclusive (June 23, 2004).

[3] Peter Cunningham and Jessica May, "Medicaid Patients Increasingly Concentrated Among Physicians," Center for Studying Health System Change, Tracking Report No. 16 (August 2006).

geographically and by type of service. For example, beneficiaries in some areas might have trouble obtaining access to primary care services. Specialists might assume a greater role in providing primary care, although the extent of that shift would depend on the number of specialists who participated in the program and their capacity to provide additional care.

In its baseline projections of Medicare expenditures, CBO has not assumed any reduction in spending on physicians' services as a result of less participation by physicians in Medicare, because the extent of any such reduction—and its implications for beneficiaries' use of services—are highly uncertain. To the extent that reduced participation would lead to lower volume and intensity of physicians' services, CBO's baseline projections may therefore overstate spending on those services.

In past years, under the sustainable growth mechanism, fluctuations in the volume and intensity of physicians' services would have led to offsetting changes in payment rates that left total spending largely unchanged. Over the next several years, however, the annual reductions in physicians' fees that will be required under that mechanism will be at their maximum amounts. Consequently, any reduction in the volume and intensity of physicians' services below CBO's projections would not be offset by a smaller reduction in physicians' fees and would therefore result in less spending on those services.

Effects on Payments to Participating Physicians. Rather than reducing their participation, some physicians could instead respond to a substantial reduction in payment rates by adjusting the amount of services they provided. Physicians play a major role in determining how much and what types of care their patients receive and thus have some ability to induce additional demand for their services. In addition, some physicians could respond to fee reductions by changing their coding practices, to bill for more complex (and more costly) services, without changing their activities. An analysis conducted by CBO concluded that physicians have responded to more modest reductions in Medicare payment rates by increasing the volume and intensity of billed services, offsetting about a quarter of the reduction in spending on physicians' services that would otherwise occur.[4] CBO uses that figure in developing its baseline projections.

There are reasons to expect, however, that a 40 percent reduction in Medicare payment rates could result in a smaller percentage offset than CBO has assumed in its baseline projections. The payment rates for some services could be reduced to amounts that are below physicians' costs of delivering the services. In that case, physicians would not have an incentive to induce demand for the service because they would lose money by doing so. Indeed, physicians might reduce the number of such services they delivered. In addition, even if the lower payment rates were sufficient to cover physicians' costs, physicians might not have the capacity to expand the services they provide by as much as CBO has assumed. For example, physicians have limited time in their workweek in which to schedule additional procedures or tests. To the extent that CBO's assumption

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[4] Congressional Budget Office, *Factors Underlying the Growth in Medicare's Spending for Physicians' Services*, Background Paper (June 2007).

overstates the increase in the volume and intensity of billed services associated with future reductions in Medicare payment rates, CBO's baseline projections of Medicare spending on physicians' services would be too high.

Another option that physicians might pursue is to stop accepting "assignment" under Medicare. (By accepting assignment, a physician agrees to accept Medicare's allowed charge as payment in full; the beneficiary's coinsurance is typically 20 percent of that amount.) At present, nearly all claims for physicians' services are accepted on assignment. Physicians who do not accept assignment receive a slightly lower Medicare payment but can receive a higher total payment for each service by charging their patients an additional amount, not to exceed 9.25 percent of the usual allowed charge (a practice known as "balance billing"). An important advantage of agreeing to accept assignment on all claims is that physicians receive payments directly from Medicare (not including the beneficiary's cost-sharing amount) rather than having to collect the total amount from the beneficiary. However, a substantial reduction in payment rates could lead some physicians to stop accepting assignment and to then charge beneficiaries increased amounts. To the extent that beneficiaries did not have coverage for those added charges through a supplemental insurance plan, their total use of services would decline slightly (though not enough to fully offset the increase in revenue that doctors obtained from balance billing). Between the lower payment that Medicare would make and the decline in demand for care, Medicare's outlays for physicians' services would probably fall slightly for doctors who took this route. CBO's baseline projections do not assume any reduction in spending for physicians' services as a result of fewer claims being accepted on assignment. To the extent that assignment rates fell as a result of the substantial reduction in Medicare's payment rates, CBO's baseline projections could therefore overstate spending on physicians' services.

Other Spending in Traditional Medicare

A significant reduction in physicians' participation in Medicare could also affect beneficiaries' use of other services and the quality of care they received. For example, reduced access to physicians' services could increase the number of beneficiaries who sought care in emergency departments. The quality and continuity of care that beneficiaries received could decline, possibly leading to poorer health outcomes. More broadly, a deterioration in beneficiaries' health status could lead to an increase in the use of other Medicare services, such as inpatient hospital care.

However, a reduction in the number of physicians who are available to admit Medicare patients could reduce the number of hospitalizations for procedures that are more elective or discretionary in nature, so whether the net effect on Medicare expenditures for inpatient hospital care would be positive or negative is unclear. Reduced access to physicians could also lower spending on prescription drugs. More generally, a significant reduction in physicians' participation in Medicare could decrease the use of some services and increase the use of others, with an unknown effect on Medicare expenditures. Consequently, CBO's baseline projections do not assume any change in spending on other services provided to enrollees in the traditional fee-for-service program

because of physicians' lower participation in Medicare that might result from the reductions in payment rates.

Spending on the Medicare Advantage Program

A substantial reduction in Medicare's physician payment rates would have two opposing effects on enrollment in the Medicare Advantage program, both of which are reflected in CBO's baseline projections. (The Medicare Advantage program is the vehicle through which beneficiaries can elect to receive their Medicare benefits from private health plans.) First, to the extent that beneficiaries had trouble obtaining access to physicians' services in the fee-for-service program, they would be more likely to enroll in Medicare Advantage plans. However, the reduction in physician payment rates would lead to lower "benchmarks" in the program (that is, the maximum payments per enrollee that plans receive from Medicare) because benchmarks increase at the same rate as national per capita Medicare expenditures. Other things being equal, lower benchmarks would reduce enrollment in Medicare Advantage plans. The amount of enrollment in Medicare Advantage plans affects Medicare expenditures because the program pays more for beneficiaries who are enrolled in such plans than it would pay for those same individuals in the fee-for-service program.

In large part, Medicare Advantage plans are attractive to some beneficiaries because they are able to offer additional benefits that are not covered by Medicare. The amount of additional benefits that a plan is able to offer at no added cost to the enrollee depends on how its per capita cost of delivering Medicare benefits (as reflected in its bid) compares with the benchmark for its service area. Medicare pays plans their bid (up to the benchmark) plus 75 percent of the amount by which the benchmark exceeds the bid, and plans are required to give that 75 percent to enrollees as additional benefits. Consequently, if plans did not reduce their bids in response to the lower benchmarks, the additional benefits they could offer enrollees would decline. In theory, plans could reduce their bids by reducing their physician payment rates to amounts at or near the rates in the fee-for-service program. In practice, however, such a large decline in payment rates would probably cause many physicians to leave the plans' networks, making them much less attractive to beneficiaries.

In your letter, you asked if Medicare Advantage plans might be able to spread reductions in payment rates across all providers and suppliers rather than concentrating them among physicians. However, plans already have an incentive to negotiate the most favorable payment rates possible with their providers, and the extent to which they could negotiate lower rates without having providers withdraw from their networks is unknown. Significant withdrawals from plans' provider networks would reduce their ability to attract enrollees.

There is considerable uncertainty about how much plans would be able to reduce their bids, how much the difference between plans' bids and their benchmarks would decrease, and how much less attractive plans would become to beneficiaries (because of a decrease in the additional benefits offered or in the size and composition of their provider networks). Moreover, beneficiaries would weigh any such reductions in the attractiveness

of plans against reductions in access to physicians' services in the fee-for-service program. Because the effects of those factors are highly uncertain and would affect the federal budget in different directions, CBO's baseline projections reflect the assumption that the substantial reduction in Medicare's physician payment rates will have no significant net effect on the percentage of beneficiaries who are enrolled in Medicare Advantage plans. Any decrease in enrollment that would normally be expected to arise from a reduction in the additional benefits offered or in the size of the plans' provider networks are assumed to be offset by the greater enrollment that would be expected because of less access to physicians' services in the fee-for-service program.

Summary

A 40 percent reduction in Medicare's physician payment rates would probably reduce physicians' participation in the program, which could lead to less use of physicians' services and greater use of emergency department services but would have an uncertain effect on the use of other Medicare services. CBO's assumption that the reduction in expenditures from lower physician payment rates would be offset by 25 percent because of a resulting increase in the volume and intensity of billed services could yield an overestimate of such spending, because there are reasons to expect that such a large reduction in payment rates might result in a smaller offset. There is considerable uncertainty about all of those effects and whether, on balance, they would increase or decrease expenditures in the traditional fee-for-service program relative to CBO's baseline projections.

The effect on spending for the Medicare Advantage program is also highly uncertain; the government's costs per enrollee might decline (because of lower benchmarks), but more people might shift to these plans, which are more expensive than the fee-for-service program. It is unclear, however, whether there would be a significant shift in enrollment; relative to the fee-for-service program, such plans might become less attractive in terms of the benefits they offer but more attractive in terms of the access they provide to physicians' services. In its baseline projections, CBO attempts to balance the uncertainty about these various factors.

In view of the uncertainty and contrasting nature of all of those factors, there is no basis at this time for concluding that CBO's baseline projections of Medicare expenditures under current law are too high or too low. CBO will continue to assess the potential impact of the various factors and adjust its methods as necessary.

Your letter also asked about potential effects on other federal health care programs such as Medicaid and the Federal Employees Health Benefits program and on private-sector health care plans. Because those federal programs provide supplemental coverage to many Medicare enrollees, spillover effects could arise—but given the great uncertainty about the direct effects within Medicare, the direction of such potential secondary effects is unclear. Whether private health plans would be affected is even more difficult to determine. Some studies have examined the impact of changes in Medicare's hospital payment rates on private payment rates, but effects of changes in physician payment rates in public programs on spending in the private sector are not well understood.

Despite the substantial uncertainties involved, I hope that this analysis is useful to you. Please contact me at (202) 226-2700 if you have any questions.

Sincerely,

Douglas W. Elmendorf
Director

Identical letters sent to the Honorable John M. Spratt Jr. and the Honorable Charles B. Rangel.

cc: Honorable Joe Barton
Ranking Member
Committee on Energy and Commerce