June 18, 2003

Honorable Charles E. Grassley
Chairman
Committee on Finance
United States Senate
Washington, DC 20510

Dear Mr. Chairman:

The Congressional Budget Office has estimated the effect on direct spending and revenues of S. 1, the Prescription Drug and Medicare Improvement Act of 2003, as reported by the Committee on Finance, and incorporating subsequent changes provided by the committee on June 17, 2003. (On June 17, 2003, CBO transmitted an estimate of S. 1 as originally reported by the Committee on Finance on June 13, 2003.)

CBO estimates that the bill would reduce direct spending by $0.2 billion in 2004 and increase direct spending by $389 billion over the 2004-2013 period (see Table 1). The bill would have no effect on federal revenues in 2004, and would increase revenues by $21 billion over the 2006-2013 period. Higher collections of payroll taxes for Social Security, which are off-budget, account for about $4 billion of that change in revenues. This estimate is preliminary pending a detailed review of the legislative language. In addition, CBO has not yet completed an estimate of the costs of activities subject to appropriation.

S. 1 contains a number of intergovernmental mandates. CBO estimates that the preemption of state premium taxes would result in revenue losses to states of about $70 million in 2006 (the first year the mandate is effective) increasing to about $95 million in 2010. Those losses would exceed the threshold established in the Unfunded Mandates Reform Act (UMRA) for intergovernmental mandates ($63 million in 2006, adjusted annually for inflation). CBO estimates that other mandates and preemptions in the bill would impose minimal or no costs on state, local, or tribal governments. Provisions of the bill affecting Medicaid would result in net savings to state and local governments of about $15 billion over the 2004-2013 period.

The bill also contains several private-sector mandates, including requirements on health insurers regarding Medigap supplemental insurance policies, on health plans and health care providers regarding the electronic transmission of prescription information, and on payers of customs user fees. CBO has not determined whether the direct costs of those mandates would exceed the threshold specified in UMRA ($117 million in 2003, adjusted annually for inflation) in any of the first five years for which the mandates would be effective.

TABLE 1. ESTIMATED EFFECT OF S. 1, THE PRESCRIPTION DRUG AND MEDICARE IMPROVEMENT ACT OF 2003, ON DIRECT SPENDING AND REVENUES

	By Fiscal Year, in Billions of Dollars											
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2004-2008	2004-2013
CHANGES IN DIRECT SPENDING												
Title I: Prescription Drug Benefit	0.6	1.4	23.5	37.0	42.9	47.8	52.6	58.5	65.0	72.6	105.5	402.0
Title II: MedicareAdvantage	0	0	0.5	0.7	0.9	0.9	1.1	1.1	1.2	1.3	2.2	7.9
Title III: Center for Medicare Choices	0	0	0	0	0	0	0	0	0	0	0	0
Title IV: Fee-for-Service Improvements	-0.4	2.5	2.4	1.0	-0.6	-1.5	-2.1	-2.6	-3.1	-3.7	4.9	-8.0
Title V: Appeals, Regulatory, and Contracting Improvements	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.5	1.2
Title VI: Other Provisions	-0.5	-0.3	-1.0	-1.0	-1.4	-1.7	-1.8	-2.0	-2.1	-2.2	-4.3	-14.1
Total	-0.2	3.7	25.6	37.8	42.0	45.7	49.9	55.2	61.2	68.2	108.8	389.0
CHANGES IN REVENUES												
Title I:												
Income and HI Payroll Taxes, on-budget	0	0	0.4	1.8	1.9	2.1	2.3	2.6	2.9	3.2	4.1	17.2
Social Security Payroll Taxes, off-budget	0	0	0.1	0.3	0.4	0.5	0.5	0.6	0.7	0.8	0.8	3.9
Total	0	0	0.5	2.1	2.3	2.6	2.9	3.2	3.6	4.0	4.9	21.1

Source: Congressional Budget Office.

HI = Medicare Hospital Insurance

Preliminary
June 18, 2003

Prescription Drug Benefit

Title I would establish an outpatient prescription drug benefit in Medicare. In 2004 and 2005, the government would offer discount cards for prescription drugs. The cards would provide a subsidy for certain beneficiaries with incomes below 135 percent of the federal poverty level, but would not subsidize other beneficiaries. Beginning in 2006, the bill would establish a prescription drug benefit, which would be offered through risk-bearing private plans. The Secretary of Health and Human Services could reduce the amount of risk borne by plans to ensure universal availability of the prescription drug benefit. Initially, the beneficiary would pay a premium of $35 a month, an annual deductible of $275, and 50 percent of costs up to $2,387.50 in out-of-pocket spending. The beneficiary would then be required to pay all costs until out-of-pocket spending for the year reached $3,700. (In subsequent years, those amounts would grow at the rate of increase in per-capita spending on prescription drugs in the Medicare program.) The beneficiary would then be responsible for 10 percent of spending above that catastrophic threshold. Spending by employer-sponsored health insurance and certain other sources would not count as out-of-pocket spending toward the catastrophic threshold.

S. 1 also would provide additional subsidies to certain individuals with incomes below 160 percent of the federal poverty level. Individuals who receive prescription drug benefits under Medicaid generally would be ineligible for the new Medicare benefit. In total, CBO estimates that title I would increase direct spending by $402 billion over the 2004-2013 period (see Table 2).

Spending by employers for health insurance that provides drug coverage to Medicare-eligible workers and retirees is a form of compensation that is not taxed. The prescription drug benefit provided under S. 1 would reduce the cost of employer-sponsored health insurance for Medicare-eligible workers and retirees. CBO assumes that savings would be returned to workers and retirees as other forms of compensation, and that some of that compensation would be taxable. We estimate that, as a result, tax revenues would increase by $21 billion over the 2004-2013 period. Receipts of Social Security payroll taxes, which are off-budget, account for $4 billion of that total.

TABLE 2. ESTIMATED EFFECT OF PRESCRIPTION DRUG BENEFIT IN S. 1, THE PRESCRIPTION DRUG AND MEDICARE IMPROVEMENT ACT OF 2003, ON DIRECT SPENDING

	By Fiscal Year, in Billions of Dollars											
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2004-2008	2004-2013
Medicare Benefit												
Benefits and Administration	0	0	30	44	49	53	58	65	72	80	123	452
Premiums	0	0	-11	-15	-16	-18	-19	-22	-24	-26	-42	-151
Subtotal	0	0	19	29	32	36	39	43	48	54	81	301
Low-income Subsidy	0	1	3	6	8	10	11	12	14	15	17	79
Medicaid	-0	-0	-1	-2	-2	-2	-2	-3	-3	-3	-5	-17
Other Direct Spending	0	1	3	4	4	5	5	5	6	7	11	39
Total	0	1	24	37	43	48	53	59	65	73	105	402
Memorandum:												
Change in state spending	0	0	-1	-2	-2	-2	-2	-2	-2	-2	-4	-15
Monthly Premium (dollars)	n.a.	n.a.	$35	$37	$40	$43	$46	$51	$54	$59	n.a.	n.a.

Source: Congressional Budget Office.

n.a. = not applicable

Preliminary
June 18, 2003

Managed Care

Title II would establish a MedicareAdvantage program to encourage a broader range of managed care plans to participate in the Medicare program. The existing Medicare+Choice program would be absorbed by the MedicareAdvantage program. The payment rates offered to plans would be the larger of per-capita spending in the fee-for-service program or rates established under current Medicare+Choice rules. Plans could choose to operate on the county basis used in the current Medicare+Choice program or on a regional basis. CBO estimates that the MedicareAdvantage program would result in about a 10 percent increase in the number of beneficiaries enrolled in plans in 2013 (from about 3.8 million in Medicare+Choice plans under current law to about 4.2 million in MedicareAdvantage plans). We estimate that the provisions of title II would increase Medicare spending by about $8 billion over the 2004-2013 period.

Other Provisions

Title III would establish the Center for Medicare Choices to administer the prescription drug benefit and the MedicareAdvantage program. The bill appropriates funding for administration of the prescription drug benefit. Those costs, which would be direct spending, are included in the estimated cost of the prescription drug benefit in title I. Funding for other activities of the new agency would be subject to appropriation of the necessary amounts. CBO has not yet completed an estimate of the effect of enacting S. 1 on spending subject to appropriation.

Title IV would modify Medicare's payment rates or coverage rules for many services, including those furnished by hospitals, skilled nursing facilities, home health agencies, physicians, and providers of durable medical equipment. S. 1 also would increase the deductible for Part B services (the amount beneficiaries must pay each year before the Medicare program will begin paying for Part B services), and would establish a copayment requirement for outpatient laboratory services. CBO estimates the provisions of title IV would reduce Medicare spending by $8 billion over the 2004-2013 period.

Title V would modify how Medicare regulations and policies are developed and enforced, and would change the procedures used to resolve disputes involving payment for services covered by Medicare. The bill would transfer certain administrative law judges from the Social Security Administration to the Department of Health and Human Services. It would change the procedures by which Medicare makes contracts with entities to process and pay

claims, and it would place new requirements on those contractors. The bill also would provide additional funding for the Medicare Integrity Program. CBO estimates the provisions of title V would increase federal spending by $1.2 billion over the 2004-2013 period.

Title VI would increase Medicaid spending for disproportionate share hospital payments for 2004 and 2005, would provide coverage under Medicaid and the State Children's Health Insurance Program for certain legal immigrants, and would provide funds to states to pay for emergency services for undocumented aliens. S. 1 also would provide loan guarantees for activities to provide capital and improve the infrastructure of the health care system, and it would extend customs user fees that expire at the end of fiscal year 2003. CBO estimates that the provisons of title VI would reduce direct spending by about $14 billion over the 2004-2013 period.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contacts are Tom Bradley (for federal costs), Leo Lex (for the state and local impact), and Bruce Vavrichek (for the private-sector impact).

Sincerely,

Douglas Holtz-Eakin
Director

cc: Honorable Max Baucus
Ranking Member