COMMITTEE FOR A
RESPONSIBLE FEDERAL BUDGET

The PREP Plan:
A Permanent Fix for the Sustainable Growth Rate

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On April 1 of this year, physicians face a 21 percent cut to their Medicare payments resulting from the return of the Sustainable Growth Rate (SGR) formula. Since 2003, Congress has continuously averted these cuts through temporary "doc fixes," but last year they came together on a bipartisan, bicameral, and Tricommittee basis to identify a *permanent* fix to the SGR that would put in place a more value-based payment model. The replacement would represent a marked improvement to Medicare's payment system, better rewarding high-quality and more coordinated care, rather than simply the number of services provided.

Rather than continuing to punt on replacing the SGR, policymakers should pursue a permanent fix in the spirit of the Tricommittee plan. However, such a plan must not add to the current law deficit, which means identifying approximately $175 billion of savings (or cost reductions within the Tricommittee bill) over the next decade to offset the full cost of reform, or $215 billion to also make permanent a host of temporary policies ("health extenders") that generally accompany doc fixes. Done right, these savings can further help efforts to improve the Medicare program and bend the health care cost curve.

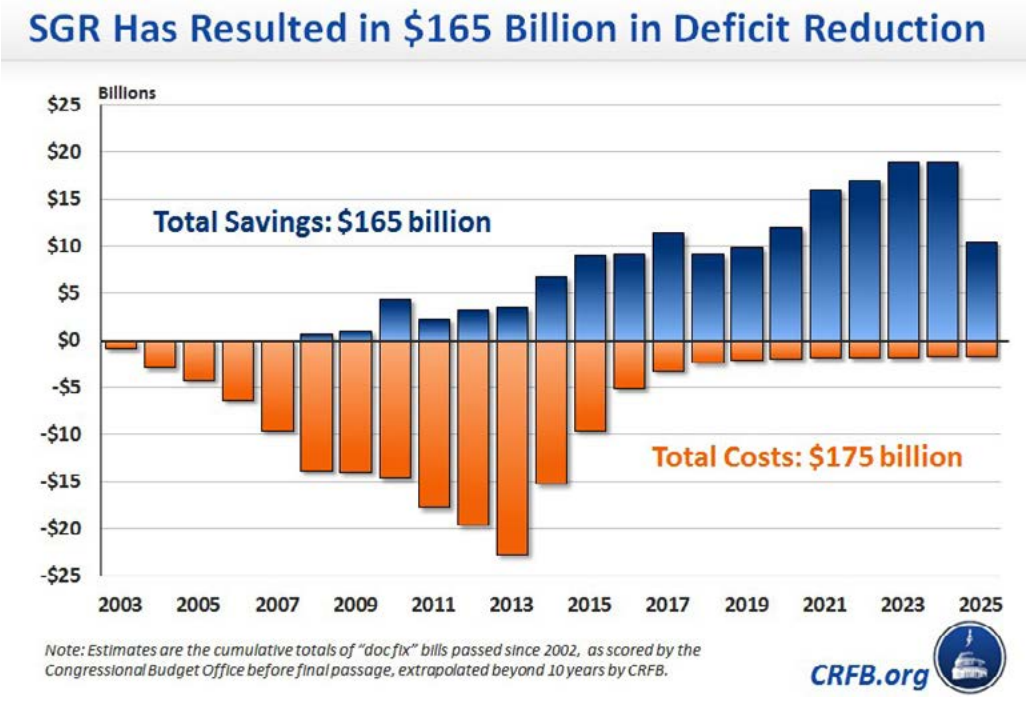
Last year, CRFB released the *Paying for Reform and Extension Policies (PREP) Plan*, which proposed specific changes to pay for permanent SGR reform (along with a variety of "tax extenders" and "health extenders"). Since then, we have updated the *PREP Plan* with new estimates and policies, outlined below. Of course, this is only one of many possible packages to offset SGR reform. But whatever options policymakers choose – and whether they pursue a permanent or temporary doc fix – they should continue the historical precedent of ensuring doc fixes do not worsen an already precarious fiscal situation.

The full 2014 *PREP Plan* is available to read here. The updated plan is discussed below.

The Importance of Paying for SGR Reform

Absent offsets, the Tricommittee SGR reform bill proposed in the Senate last year, including the cost of health extenders, would add $215 billion to the debt, before interest, over the next decade alone. On a present-value basis, a permanent doc fix could cost *$2.3 trillion* or more over the next 75 years, according to Centers for Medicare and Medicaid Services (CMS) actuaries.

Failing to pay for these costs would not only be unacceptable from a fiscal perspective, but also a setback for health reform, not to mention a break in precedent. Despite suggestions to the contrary, doc fixes have almost always been paid for in the past – almost entirely with other health savings and often with small but important reforms that improve the way we deliver and finance Medicare. Indeed, since 2004, 98 percent of doc fixes have been paid for. And although these doc fixes have cost about $175 billion, the pay-fors have generated roughly $165 billion worth of savings.



Thought of another way, even though the SGR has not functioned as intended, it has served as an action-forcing mechanism to prompt targeted health savings in place of its prescribed blunt, across-the-board cuts.

Principles for SGR Reform

There is no one right way to replace the SGR; as lawmakers consider SGR packages, they should look to the many replacement and offset options that have already been put forward by the President's budget, Simpson-Bowles, Domenici-Rivlin, the Center for American Progress, the Heritage Foundation, the Brookings Institution, the National Coalition on Health Care, and others.

As policymakers review these options, they should keep in mind three important principles we outlined in our *PREP Plan* paper last year:

1. Permanently replace the SGR with a value-based payment system
2. Fully offset any costs relative to current law
3. Enact offsets that bend the health care cost curve and are gimmick-free

CRFB supports not only our *PREP Plan*, but any SGR replacement plan that meets these three principles. A large list of possible health offsets not in the *PREP Plan* can be found here.

The PREP Plan

The PREP Plan assumes that lawmakers enact the Tricommittee bill along with various "health extenders," and identifies offsets that improve incentives throughout the health care system to slow cost growth. The offsets would save $215 billion – specifically, $100 billion from improving provider incentives, $100 billion from improving beneficiary incentives, and the remaining $15 billion from Medicaid. In the second decade, these offsets could save roughly *$700 billion*. Details are available on the next page.

Importantly, the *PREP Plan* is not the only way to pay for SGR reform – policymakers have numerous options. Regardless of details, the return of the SGR should be viewed as an opportunity to pursue fiscally responsible health reforms, not an excuse to add to the debt.

Policy	Ten-Year Cost
Enact Tricommittee SGR Reform and Extend Health Extenders	**$215 billion**
Reform Provider Incentives	**-$100 billion**
Expand the use of bundled payments and reform ACOs	-$50 billion
Equalize payments for similar services performed in different settings	-$30 billion
Encourage low-cost physician-administered drugs	-$10 billion
Reduce preventable readmissions and unnecessary complications	-$10 billion
Reform Beneficiary Incentives	**-$100 billion**
Modernize Medicare Part A and Part B cost-sharing rules	†
Provide reduced cost-sharing for low-income seniors	†
Restrict first-dollar coverage for Medigap plans	†
Encourage cash out of employer retiree health plans	†
Reduce Medicaid Costs	**-$15 billion**
Restore provider tax threshold to 5.5%	-$10 billion
Rebase Medicaid DSH payments	-$5 billion
Expand waivers for Medicaid cost-control	*
Total Offsets	**-$215 billion**

Numbers are rounded to the nearest $5 billion. *Less than $500 million in costs or savings
†Due to interactions, policies cannot be scored on an individual basis

Details of The PREP Plan

Improve Provider Incentives ($100 billion):

Expand the use of bundled payments and reform ACOs ($50 billion). Currently, Medicare primarily relies on a "fee-for-service" (FFS) model that pays providers based on the quantity of services provided, encouraging overtreatment and under-coordination of care. *The PREP Plan* would help move Medicare away from FFS both by utilizing more "bundled payments" that encourage care coordination and by adopting reforms to improve Accountable Care Organizations (ACOs). Developed by the Dartmouth Institute for Health Policy and Clinical Practice, Dartmouth-Hitchcock Health, and Fix the Debt, these ACO reforms would better engage patients in their own care, remove regulatory barriers, and make the ACO financial model more sustainable.

Equalize payments for similar services performed in different settings ($30 billion). Medicare often pays vastly different rates for similar health care services based on the setting in which they are performed. *The PREP Plan* would equalize these payments to reduce payment disparities as well as reduce the incentives for hospitals to buy freestanding physician offices.

Encourage low-cost physician-administered drugs ($10 billion). Medicare currently encourages physicians to administer the most expensive among equivalent drugs by reimbursing them at the Average Sales Price (ASP) plus 6 percent. *The PREP Plan* would instead pay doctors the ASP plus a flat fee so that doctors use the best, rather than the most expensive, drug for their patients.

Reduce preventable readmissions and unnecessary complications ($10 billion). *The PREP Plan* would expand and increase existing penalties for preventable readmissions, hospital-acquired conditions, and avoidable complications.

Improve Beneficiary Incentives ($100 billion):

Modernize Medicare Part A and Part B cost-sharing rules, including new cost-sharing assistance for lower-income seniors. Currently, Medicare's beneficiary cost sharing is complex and disjointed, is often unrelated to the cost of the service provided, and offers no protection against catastrophic costs. *The PREP Plan* would simplify cost-sharing with a single Part A and B deductible, more uniform coinsurance, and an out-of-pocket maximum to protect seniors against exorbitantly high costs and medical bankruptcy. Deductibles and the out-of-pocket maximum would also vary based on income. Combined with the policies below, this plan would not only save Medicare money, it *could reduce average out of pocket costs for seniors by $280 annually*. Details are available here.

Restrict first-dollar coverage for Medigap plans. Medigap plans provide supplemental coverage for seniors, but in so doing, significantly increase overutilization and drive up costs for seniors as well as the Medicare program. *The PREP Plan* would restrict Medigap plans from covering first-dollar costs, with special rules to ease the transition. The new out-of-pocket maximum would serve as protection against high beneficiary costs.

Encourage cash out of employer retiree health plans. Like Medigap plans, employer-provided supplemental health plans tend to drive up costs and utilization. *The PREP Plan* would enable employees to "cash out" the value of their retiree health plans in exchange for premium subsidies, while increasing Medicare premiums for those who retain such plans.

Reduce Medicaid Costs ($15 billion):

Restore provider tax threshold to 5.5 Percent ($10 billion). Many states rely on a gimmick known as the provider tax to inflate the funding they receive from the federal government. Restrictions on this gimmick are relatively loose, allowing states to tax as much as 6 percent of hospital revenue, up from 5.5 in 2011. *The PREP Plan* would restore the 2011 limit.

Rebase Medicaid DSH payments ($5 billion). Because the Affordable Care Act increased health insurance coverage, it was able to reduce payments to compensate hospitals for treating uninsured patients. These reductions expire after 2024 under current law, but the *PREP Plan* would continue them permanently.

Encourage states to experiment more with cost control. Given that the Medicaid program is administered by the states, the *PREP Plan* would encourage more states to experiment with their own ideas to improve the cost and value of care under Medicaid by expanding waivers.