Medicare's physician payment update formula: The facts

Medicare physician payment rates are slated to be reduced by 10.6 percent in July 2008 under current law. The 2007 Medicare Trustees report predicts cumulative reductions in Medicare physician payment rates of about 40 percent in the coming decade. These successive annual reductions are due to a statutory formula governing annual Medicare payment updates that is broken beyond repair and must be replaced.

It is critical that Congress take immediate action to replace the next 18 months of cuts with positive updates based on practice cost increases, because this payment formula is producing disastrous effects. Congress also needs to pave the way for a longer-term reform of this physician update system. In addition to generating the pending steep pay cuts, the formula:

- **Has kept average 2008 Medicare physician payment rates about the same as they were in 2001**
- **Prevents physicians from making needed investments in staff and health information technology to support quality measurement (a 2007 AMA survey found that 54 percent of physicians would have to reduce staff and 67 percent would defer purchasing information technology if payments are cut 10 percent this year)**
- **Punishes physicians for participating in initiatives that encourage greater use of preventive care in order to reduce hospitalizations**
- **Has led to severe shortfalls in Medicare's budget for physician services that have driven Congress to enact short-term interventions with funding methods that have increased the duration of cuts, as well as the cost of a long-term solution**

Background

The law provides for Medicare physician payment rates to be updated each year:

- Each year's payment update calculation starts with the Medicare Economic Index or MEI, which is a conservative government index of practice cost inflation.
- The update is then adjusted up or down from MEI based on a seriously flawed national spending target called the Sustainable Growth Rate (SGR).
- The SGR was created by Congress in 1997 as a target rate of growth in Medicare spending for physician services.
- The key factors in setting the SGR are Gross Domestic Product (GDP) growth, Medicare enrollment, price changes and changes in Medicare benefits or other changes in law.
- If spending exceeds the SGR targets, then annual physician payment updates are less than annual increases in practice cost inflation, even if they produce steep reductions from current payment rates.

SGR fatal flaws

There are several fatal flaws in the SGR:

- Utilization of physician services grows more rapidly than GDP, so using GDP as the standard for utilization growth in the SGR means that the target is always set too low.
- The "law and regulation" factor has not been appropriately adjusted to reflect new Medicare coverage policies, such as macular degeneration treatment and implantable cardiac defibrillators. Omitting the costs of such treatments from the SGR targets increases the likelihood of pay cuts.
- None of the factors in the SGR recognize Medicare spending due to technological advances, shifts from

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care being provided in hospitals to being provided in physician offices and other medical practice trends. Services that may save money for the Medicare program as a whole or improve quality, therefore, can still lead to cuts in Medicare physician payment rates.
- Medicare expenditures for drugs administered in physician offices are improperly included in SGR calculations and have been growing much more rapidly than physician services. The cost of these drugs is not a "physician service" and should be excluded from these calculations. As repeated attempts have not yet convinced policymakers to remove the drug costs, the SGR formula calculations are grossly inaccurate.

Impact of cuts on patient access

Surveys have shown that SGR-driven pay cuts would hurt seniors' access to physician care:
- An AMA survey of 8,955 physicians found that 60 percent would have to limit the number of new Medicare patients they treat if payments are cut 10 percent in 2008.
- The Medicare Payment Advisory Commission has found that 30 percent of Medicare beneficiaries seeking a new primary care physician have trouble finding one. The Commission is concerned that Medicare pay cuts will worsen patient access problems.
- The Military Officers Association of America states SGR pay cuts would significantly damage military beneficiaries' access to care under TRICARE, as TRICARE payments are linked to Medicare rates.
- The congressionally-created Council on Graduate Medical Education is already predicting a shortage of 85,000 physicians by 2020. Medicare cuts will exacerbate this shortage by making medicine a less attractive career.

Value of physician services

Physician services have extended patients' lives and improved seniors' quality of life, despite a significant rise in chronic disease among the elderly:
- The Centers for Disease Control reported 50,000 fewer deaths in 2004, the biggest single-year reduction in mortality since the 1930s.
- An August 2006 *Health Affairs* article by Kenneth Thorpe and David Howard found that "[v]irtually all of the growth in spending from 1987 to 2002 can be traced to the twenty-percentage-point increase in the share of Medicare patients receiving medical treatment for five or more conditions during a year."
- Medical advances added about a half year to seniors' life spans between 1999 and 2002 alone. Deaths from heart and cerebrovascular disease have been falling by about 3 percent a year in recent years and the cancer death rate over the last decade has fallen by about 1 percent a year.
- An August 2006 *New England Journal of Medicine* article by David Cutler et al. concluded that, "although medical spending has increased over time, the return on spending has been high… concern about high medical costs needs to be balanced against the benefits of the care received."
- Utilization of physician services is not the cause of the Medicare program's financial predicament, and cuts in physician payment rates are not the way to improve Medicare's financial sustainability.

Congress needs to: 1) replace looming Medicare physician payment cuts with 18 months of positive updates that reflect practice cost increases to ensure seniors' access to care; and 2) pave the way for permanent replacement of this formula.