APPENDIX

A

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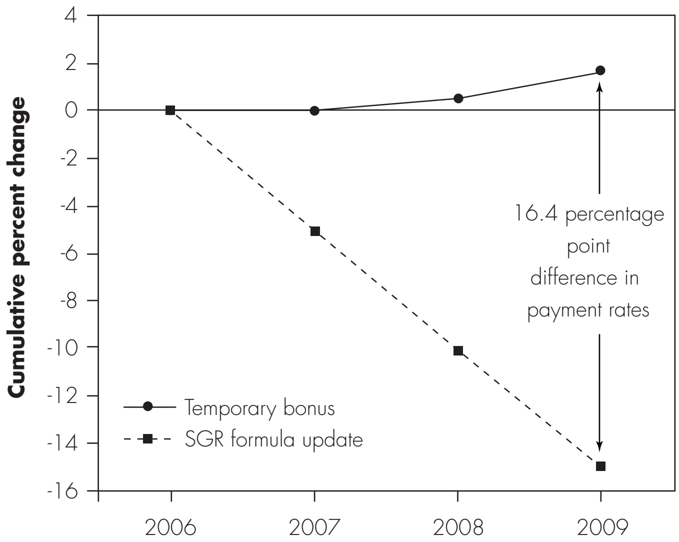
In CMS's annual letter to the Commission on the update for physician services, the agency's preliminary estimate of the 2010 update is –21.5 percent (Richter 2009). Most of the reduction is due to a series of temporary bonuses enacted over several years that will expire at the end of 2009. These bonuses prevented negative updates under the sustainable growth rate (SGR) formula—the statutory formula for updating Medicare's payment rates for physician services—that would have occurred in 2007, 2008, and 2009. Expiration of the bonuses will require an update of –16.4 percent to bring payment rates to the level where they would have been had the SGR formula's updates occurred. The remainder of CMS's estimate is the formula's update for 2010: –6.1 percent.[1]

This appendix provides our mandated technical review of CMS's estimate. We find that—absent a change in law—the update is very unlikely to differ substantially from –21.5 percent. The bonuses to override the SGR formula's updates were specified in law and are not subject to change. The SGR update for 2010 could change between now and when CMS implements the update in January but only by a small amount. According to the formula, the update is the projected change in input prices for physician services, adjusted by a factor to align spending with a target. While CMS's estimate of a 1.0 percent change in input prices may change, the agency's estimate of an update adjustment of –7.0 percent is the dominant factor, and it is very unlikely to change. By law, the update adjustment is limited to –7.0 percent. Without this limit, the adjustment calculated with the formula would be more than four times larger: –29.6 percent. Because the calculated adjustment exceeds the limit by such a large margin, it is very unlikely that an input to the calculations—such as the level of physician spending—will change enough to make the adjustment any amount other than –7.0 percent.

Before presenting the details of our technical review, we remind readers that the Commission is not satisfied with the current physician payment update mechanism. It does not provide incentives for individual physicians to control volume growth, and it is inequitable to those physicians who do not increase volume unnecessarily. And it continues to call for substantial negative updates through at least 2016. Such reductions in physician payment rates, if they take place, would threaten beneficiaries' access to physician services. Our report *Assessing Alternatives to the Sustainable Growth Rate System* examined several alternative approaches for updating physician payments and made suggestions to improve the accuracy of Medicare's payments, create incentives for physicians to provide better quality of care, coordinate care across settings, and use resources judiciously (MedPAC 2007).

FIGURE A–1

Temporary bonuses prevented the SGR formula's negative updates



Note: SGR (sustainable growth rate). The 16.4 percentage point difference is the ratio of the cumulative SGR formula updates to the cumulative temporary bonuses (0.8495/1.0161 = 0.8360 or –16.4 percent).

Source: Richter 2009 and Office of the Actuary 2009.

How temporary bonuses and other legislative provisions have affected payments for physician services

The SGR formula is intended to limit growth in Medicare spending for physician services. If aggregate spending exceeds a specified target in a given year, the formula calls for a downward adjustment in the physician fee schedule's conversion factor.

In recent years, the Congress has overridden the formula's updates. Spending has exceeded the target, and updates calculated with the formula have been negative. However, except for the negative update implemented in 2002, the Congress has passed specific legislation for each year to prevent further negative updates. The most recent of these overrides prevented negative updates that would have occurred in 2007, 2008, and 2009.

These three overrides were temporary bonuses that will expire at the end of 2009, totaling a cumulative increase in payment rates of 1.6 percent (Figure A-1).[2] Had the Congress not overridden the formula with these bonuses, the cumulative decrease in payments would have been 15.0 percent. The difference is the –16.4 percent figure mentioned earlier.

The bonuses for 2007, 2008, and 2009 were among a series of temporary updates that started with the update for 2004. Unlike the earlier interventions, however, the 2007–2009 bonuses were enacted with explicit expiration dates. In other words, legislation specified that, when the bonuses expire, updates are to be calculated with the formula as if the bonuses had never been applied. By contrast, when the Congress acted to override the SGR formula's updates for years before 2007, the updates were not set to expire on a specific date. Instead, legislation prescribed a positive update for a given year, allowing spending to rise above the level called for in the formula. The expectation was that the formula would gradually recoup the spending increase in later years.

In addition to the temporary bonuses, recent legislation has increased payments for physician services in other ways. For instance, the Medicare Improvements for Patients and Providers Act of 2008 (MIPPA) increased bonuses under the Physician Quality Reporting Initiative to 2 percent of allowed charges for 2009 and 2010. Previously, the bonuses were 1.5 percent of allowed charges. MIPPA also established incentives for electronic prescribing. This program allows physicians to receive in 2009 and 2010 a 2 percent bonus on their allowed charges if they meet the program's requirements.[3] Through 2009, MIPPA extended higher payments for some areas through the floor on the physician fee schedule's geographic practice cost index (GPCI) for physician work.

How CMS estimated the SGR formula's update for 2010

Calculating the physician update is a two-step process. CMS first estimates the SGR—the target growth rate for allowed spending on physician services—for the coming year. The agency then computes the update using that SGR and historical information on actual and allowed spending.

SGR for 2010

The SGR is a function of projected changes in:

- productivity-adjusted input prices for physician fees—an allowance for inflation,[4]

- real gross domestic product (GDP) per capita—an allowance for growth in the volume of services,[5]
- enrollment in fee-for-service (FFS) Medicare—an allowance for fluctuations in the number of FFS beneficiaries, and
- spending attributable to changes in law and regulation—an allowance for policy changes that affect spending on physician services.

Allowing for these four factors, CMS's preliminary estimate of the SGR for 2010 is –8.2 percent (Table A-1).

TABLE A–1

Preliminary estimate of the sustainable growth rate, 2010

Factor	Percent
2010 change in:	
Input prices for physician services*	1.2%
Real GDP per capita	0.8
Fee-for-service enrollment	–0.3
Change due to law or regulation	–9.7
Sustainable growth rate	–8.2

Note: GDP (gross domestic product). Percentages are converted to ratios and multiplied, not added, to produce the sustainable growth rate. Estimates shown are preliminary.
*The change in input prices includes inflation measures for services furnished by a physician or in a physician's office. It is adjusted for productivity growth.

Source: Richter 2009.

The first of these factors—the estimated change in input prices of 1.2 percent—is lower than the figure for previous years. Given economic conditions, CMS projects relatively modest increases for physician compensation, staff earnings, rent, and other inputs. The Congressional Budget Office (CBO) is also projecting low inflation in input prices (CBO 2009a).

The next factor in the 2010 SGR—growth in real GDP per capita—is a 10-year moving average. It includes estimates of economic growth for 2001 through 2008 and projections for 2009 and 2010. CMS's estimate of 0.8 percent for this factor is not far from the 0.7 percent estimate that we calculate when we replace CMS projections for 2009 and 2010 with like projections from CBO (CBO 2009a).

For the factor on the change in FFS enrollment, CMS projects a decrease of 0.3 percent. CBO has a similar (fiscal year) projection: a decrease of 0.2 percent (CBO 2009b). A decrease would occur because of a shift in enrollment from Medicare FFS to Medicare Advantage.

The remaining factor in the 2010 SGR is a –9.7 percent change in spending due to law and regulation. Here, CMS anticipates that some changes in spending—such as a decrease when the floor on the work GPCI expires at the end of 2009 and an increase when incentives for electronic prescribing start in 2010—will mostly offset each other. That leaves expiration of the temporary bonuses as the primary source of the –9.7 percent change in spending that CMS estimates for the factor.

A change in spending of this magnitude may appear small relative to the –16.4 percent change in payment rates cited earlier. Note, however, that the expiring bonuses would affect only about 80 percent of the spending that meets the SGR formula's definition of spending for physician services. The other 20 percent is spending for Part B drugs and laboratory services. In addition, the law and regulation factor in the SGR is not an estimate of a change in payment rates; it is an estimate of a change in spending. A change in payment rates would not necessarily equal a change in spending if the change in payment rates were accompanied by a change in the volume of services. Indeed, when projecting a decrease in payment rates, CMS offsets the decrease by almost a third to account for a volume increase, consistent with the agency's research (Codespote et al. 1998). This perspective makes clearer the rationale for CMS's estimate of the law and regulation factor in the 2010 SGR: If volume goes up when the bonuses expire and payment rates go down, spending will decrease by less than the decrease in payment rates.

Calculating the SGR formula's update for 2010

After estimating the SGR, CMS calculates the update, which is a function of:

- the change in productivity-adjusted input prices for physician services, as measured by the Medicare Economic Index (MEI);[6] and
- an update adjustment factor (UAF) that increases or decreases the update as needed to align actual spending, cumulated over time, with target spending determined by the SGR.

TABLE A–2

Preliminary estimate of the SGR formula's update for 2010

Factor	Percent
Change in input prices	1.0%
Update adjustment factor	–7.0
Update	–6.1

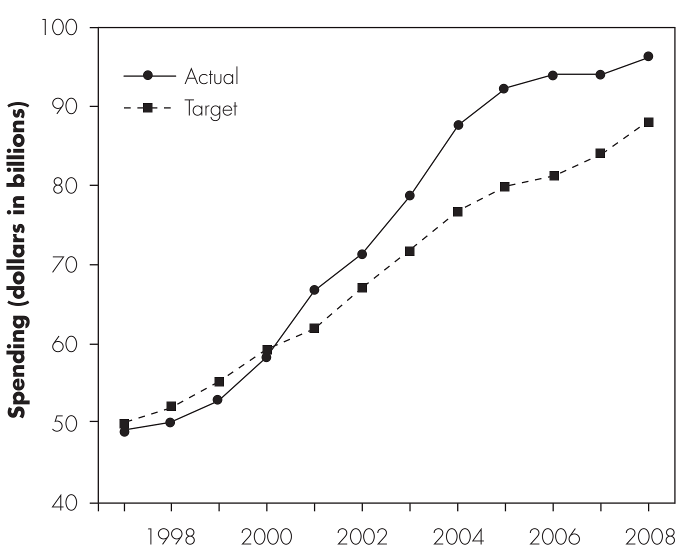
Note: SGR (sustainable growth rate). Percentages are converted to ratios and multiplied, not added, to produce the update. Estimates shown are preliminary.

Source: Richter 2009.

The estimate of the change in input prices for use in the 2010 update is 1.0 percent (Table A-2).[7] The part of the update calculation that has the larger effect, however, is the UAF. For 2010, CMS estimates a UAF of –7.0 percent, which is the maximum negative adjustment permitted under current law. Combining this adjustment with the estimated change in input prices results in an update estimate of –6.1 percent.

FIGURE A–2

Since 2001, actual spending for physician services has exceeded the target



Note: Estimates shown are preliminary.

Source: Office of the Actuary 2009.

The UAF is negative because actual spending for physician services has exceeded the target every year since 2001 (Figure A-2). As the deficit has grown, the formula has called for payment reductions, but the Congress has overridden the formula. According to CMS's estimates, the UAF without the statutory limit would now be –29.6 percent. Thus, CMS's update estimate (–6.1 percent) is unlikely to change by a substantial amount because a UAF of –29.6 percent is well beyond the limit (–7.0 percent). For this reason, the Commission anticipates that no alteration in the factors of CMS's estimates would be large enough to bring the UAF within the limit.

The only remaining issue in calculating the update concerns CMS's estimates of actual spending. When calculating the preliminary estimate of the 2010 update, CMS had data on actual spending that were nearly complete for the first three quarters of 2008 but less so for the last quarter of that year (OACT 2009). As more data become available, the estimate of actual spending in 2008 may change somewhat before CMS issues a final rule on the update in November. The estimates of actual spending for 2009 could change also. In any case, any uncertainty in these estimates is very unlikely to overcome a UAF of –29.6 percent. Therefore, we anticipate that CMS will revise the update calculations this fall, in preparation for implementing the 2010 update on January 1, and that—absent a change in law—the update will not differ substantially from CMS's preliminary estimate of –6.1 percent. In turn, when the formula's update for 2010 is implemented at the same time that the temporary bonuses expire, the combined effect is very unlikely to differ substantially from CMS's estimate of a physician update of –21.5 percent. ■

Endnotes

1 For the update calculations discussed in this appendix, percentages are not added. Instead, they are converted to ratios and multiplied. For instance, the estimate of the update for 2010 is the arithmetic product of the expiring bonuses (–16.4 percent, or 0.836) and the formula's update for 2010 (–6.1 percent, or 0.939). The multiplication is 0.836 × 0.939 = 0.785, or –21.5 percent.

2 For 2007, the Tax Relief and Health Care Act of 2006 maintained payment rates at 2006 levels. For the first six months of 2008, the Medicare, Medicaid, and SCHIP Extension Act of 2007 raised payment rates by 0.5 percent. For the second six months of 2008, the Medicare Improvements for Patients and Providers Act of 2008 (MIPPA) maintained payment rates at the levels for the first six months of that year. For 2009, MIPPA raised payment rates by 1.1 percent.

3 The bonuses gradually fall to 0.5 percent in 2013. Starting in 2012, physicians are subject to payment reductions if they do not use electronic prescribing.

4 For calculating the SGR, physician fees include fees for services commonly performed by a physician or in a physician's office. In addition to physician fee schedule services, these fees include diagnostic laboratory tests and most of the drugs covered under Medicare Part B.

5 As required by the Medicare Prescription Drug, Improvement, and Modernization Act of 2003, the real GDP per capita factor in the SGR is a 10-year moving average.

6 For the update, physician services include only those services billable under the physician fee schedule.

7 In its March 2009 report, the Commission discussed a CMS forecast of change in the MEI in 2010 that equaled 2.4 percent. The forecast in the Commission's report differs from the MEI increase of 1.0 percent in CMS's preliminary estimate because—as required by law—the increase in the preliminary estimate is adjusted for productivity growth. That is, the 1.0 percentage point increase includes an adjustment for productivity growth of 1.3 percentage points. The other reason the MEI numbers differ is that the increase of 1.0 percent is not a forecast for 2010. Instead, it is an estimate of historical change—in this case, from 2008 to 2009.

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