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Glenn M. Hackbarth, J.D., Chairman
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The Honorable Richard B. Cheney
President of the Senate
U.S. Capitol
Washington, DC 20515

Dear Mr. Vice President:

The Balanced Budget Refinement Act of 1999 (BBRA) included a number of technical corrections to the formula that is used to update Medicare's payment rates for physician services. This formula, called the sustainable growth rate system, ties the updates to growth in the beneficiary population, changes in input prices for physician services, and changes in spending due to law and regulations. The formula then adjusts the updates if growth in use of services per beneficiary is different from per capita growth in the national economy. The BBRA also required the Secretary of Health and Human Services, acting through the Agency for Healthcare Research and Quality (AHRQ), to conduct a study on use of physician services by Medicare beneficiaries. This requirement was a response to concerns that the update formula may not adequately account for advances in technology, changes in the demographic characteristics of the beneficiary population, and other factors that affect use of physician services. AHRQ has completed the study, and MedPAC is pleased to have the opportunity to comment on it.

Our comments focus on the study's main findings, which address the question of whether it is possible to measure the effects of certain factors affecting use of physician services and to adjust the update formula to account for those factors. The study's main findings are:

- The per capita volume of physician services used by Medicare beneficiaries increased by more than 30 percent between 1993 and 1998. The study could not definitively explain this growth and concluded that the main driver was a general increase in the use of care, with only a few medical conditions having unusual effects on service use. The study reached no conclusion about whether the increases were appropriate.
- Among the factors affecting use of physician services, the effects of some factors are measurable, but they are small. For instance, the study considered the effects of beneficiary characteristics—age, place of residence, and health status—and found that, if anything, changes in these characteristics would have decreased, rather than increased, per beneficiary use of services.

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- Technological change contributed to the increase, but accounting for it in the update formula would be very difficult. It would be necessary to analyze the effects of technology for each of the many medical conditions experienced by Medicare beneficiaries and to estimate whether technology will result in a net increase or decrease in service use. In addition, it would be necessary to change this estimate every year because technology's effects are not constant.

These findings are consistent with MedPAC's work on growth and variation in use of physician services. For our June 2003 Report to the Congress: Variation and Innovation in Medicare, we analyzed Medicare claims data for 1999 to 2002 and found rapid growth in use of some physician services, particularly imaging and tests. We have also found wide variation, geographically, in use of physician services. John Wennberg, Elliott Fisher and others have interpreted such findings as evidence that some of this variation represents overuse of services. Underuse is another possible source of variation in use of physician services.

All these findings raise questions about whether changes in Medicare payment policies are necessary to address issues of growth and variation in use of physician services. We are continuing work on this and plan to address these issues in a report to the Congress.

One further comment on the AHRQ study concerns its estimates of spending for physician services. We compared these estimates with similar estimates in the report of the trustees of the Medicare trust funds and found some differences. The differences are large enough to warrant review of the estimates by AHRQ and an explanation of the differences. We are following up on this with the agency.

Thank you again for the opportunity to comment on this study.

Sincerely,

Glenn M. Hackbarth
Chairman

Honorable Richard B. Cheney

Identical letter sent to the Honorable J. Dennis Hastert

cc: Honorable Charles E. Grassley, Chairman, Senate Committee on Finance
Honorable Max Baucus, Ranking Member
Honorable William M. Thomas, Chairman, House Committee on Ways and Means
Honorable Charles B. Rangel, Ranking Member
Honorable Nancy L. Johnson, Chairman, Subcommittee on Health, House Committee on
Ways and Means
Honorable Pete Stark, Ranking Member
Honorable W.J. "Billy" Tauzin, Chairman, House Committee on Energy and Commerce
Honorable John D. Dingell, Ranking Member
Honorable Michael Bilirakis, Chairman, Subcommittee on Health, House Committee on
Energy and Commerce
Honorable Sherrod Brown, Ranking Member
Honorable Tommy G. Thompson, Secretary, U.S. Department of Health and Human
Services
Honorable Thomas A. Scully, Administrator, Centers for Medicare and Medicaid
Services
Carolyn M. Clancy, M.D., Agency for Healthcare Research and Quality
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