APPENDIX

Review of CMS's preliminary estimate of the physician update for 2007

A P P E N D I X

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CMS's preliminary estimate of the 2007 payment update for physician services is –4.6 percent, the maximum negative update permitted under a formula defined in statute (Kuhn 2006). This is the third consecutive estimate of such a large negative update, although a negative update has not occurred since 2002 as the Congress has overridden the formula.

In communicating the estimate to the Commission, CMS reminds us that an important reason the formula continues to call for negative updates is that the volume of physician services is growing rapidly. In this context, physician services include services paid for under Medicare's physician fee schedule as well as laboratory services and physician-administered drugs. For 2005, CMS's estimate is that the volume and intensity of physician services per beneficiary grew by 7.5 percent. While that estimate is preliminary and so may change, it is higher than the average for the previous five years, which was 6.1 percent.[1] The estimate also exceeds the growth in any of the previous five years except 2004, when spending grew by 8.0 percent. CMS is working with physicians and other stakeholders to review and understand this growth with a goal of helping Medicare beneficiaries receive better and more efficient care.

The Commission shares CMS's concern about volume growth. In March 2006, we recommended changes in the way services are valued in the physician fee schedule (MedPAC 2006). The concern is that misvaluing services could create financial incentives that lead to increases in volume. Our other work on mispricing includes consideration of the data and methods for determining payments for physicians' practice expenses (see Chapter 4). We are also exploring ways to give physicians feedback on how their volume of services compares with that of their peers (see Chapter 1).

This appendix fulfills the Commission's requirement to review CMS's estimate of the update. In reviewing the technical details involved in estimating the update, we find that CMS used estimates in calculating the update that are consistent with recent trends. Note that our purpose in reviewing CMS's estimate is not to assess the adequacy of the update.[2] In Congressional testimony and reports to the Congress, we have discussed several problems with the physician update formula (Hackbarth 2005a, Hackbarth 2005b, MedPAC 2005, MedPAC 2002). We consider the current formula to be a flawed, inequitable mechanism for volume control and will consider alternatives to it in a report that is due in March 2007.

Calculating the update

Calculating the physician update is a two-step process. First, CMS estimates the sustainable growth rate (SGR). The SGR is the target rate of growth in spending for

TABLE A–1

Preliminary sustainable growth rate, 2007

Factor	Percent
Change in:	
input prices	2.6%
traditional Medicare enrollment	–2.9
real GDP per capita	2.2
Change due to law and regulations	–1.0
Sustainable growth rate	0.7

Note: GDP (gross domestic product). Percents are converted to ratios and multiplied, not added, to produce the sustainable growth rate.

Source: Kuhn 2006.

physician services and is a function of projected changes in:

- input prices for physician services;[3]
- real gross domestic product (GDP) per capita, an allowance for growth in the volume of services;[4]
- enrollment in traditional fee-for-service Medicare; and
- spending attributable to changes in law and regulation.

For 2007, CMS's preliminary estimate of the SGR is 0.7 percent (Table A-1).

Second, CMS calculates the update, which is a function of:

- the change in input prices for physician services,[5] and
- an update adjustment factor that increases or decreases the update as needed to align actual spending, cumulated over time, with target spending determined by the SGR.

The estimate of the change in input prices for 2007 is 2.6 percent (Table A-2). The part of the update calculation that has the bigger effect, however, is the update adjustment factor, which CMS estimates at –7.0 percent. That is the maximum negative adjustment permitted under current law. When we combine this adjustment with the estimated change in input prices, the result is an update of –4.6 percent.

The update adjustment factor is negative because actual spending for physician services started to exceed the target in 2001 (Figure A-1). Since then, volume growth has kept spending above the target. In addition, overrides of the formula (where the Congress has changed the law to prevent negative updates) have kept payment rates above the level necessary to align actual spending and the target. The result is that the update adjustment factor would be –28.0 percent, if not for the –7.0 percent limit.

Reviewing CMS's estimates

Because an update adjustment factor of –28.0 percent is well beyond the statutory limit, the Commission anticipates no changes in CMS's estimates that would be large enough to bring the factor within the limit and, therefore, alter the update. In the 2007 SGR, the estimate of the change in input prices, as measured by the Medicare Economic Index (MEI), is similar to changes in the MEI for earlier years.[6] The change in real GDP per capita of 2.3 percent equals the 10-year moving average of real GDP estimates from the Bureau of Economic Analysis (BEA), adjusted for population growth (BEA 2006).

In the 2007 SGR, the change in spending due to law and regulation is noteworthy in that it is negative. Usually, this component of the SGR is positive to account for spending increases that occur when legislation expands benefits under Medicare Part B. For 2007, CMS expects law and regulation to have a negative effect on spending for two reasons. First, payment rates will fall in some geographic areas when the floor on the geographic practice cost index for physician work expires. The floor was established by the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (MMA) and ends on December 31, 2006. Second, payment rates for certain imaging services will go down under provisions of the Deficit Reduction Act of 2005 (DRA).

TABLE A–2

Estimate of the update for physician services, 2007

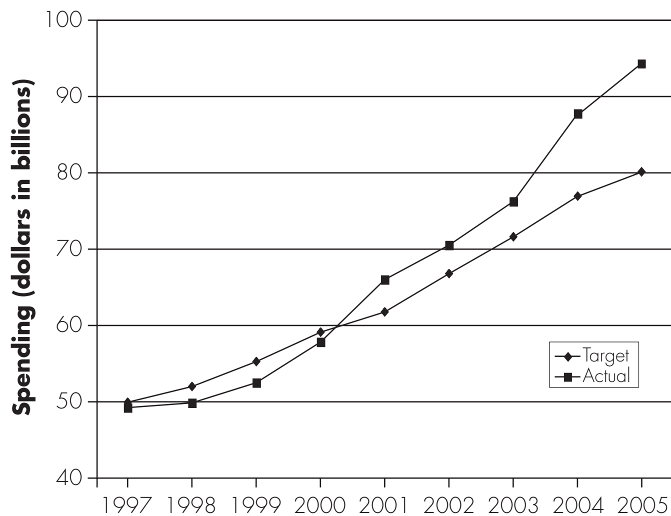
Factor	Percent
Change in:	
input prices	2.6%
adjustment factor	–7.0
Update	–4.6

Note: Percents are converted to ratios and multiplied, not added, to produce the update.

Source: Kuhn 2006.

FIGURE A–1

Through 2005, actual spending for physician services exceeded target



Note: The estimates shown are preliminary and so may change.

Source: Office of the Actuary 2006 and Kuhn 2006.

A physician specialty society, the American College of Radiology, has raised a question about the magnitude of the change in spending due to law and regulation that will occur in 2007. CMS's estimate of an average change in payment rates of –1.0 percent is consistent with the Congressional Budget Office's (CBO's) budget scoring of the MMA and DRA provisions. The American College of Radiology believes that CBO has underestimated the payment reductions that will occur under the DRA by more than 50 percent (ACR 2006). While we can not assess the magnitude of these estimates, we note that CMS reviews and validates estimates in SGRs as data become available and that the agency has two years to revise an SGR with better data.[7] In addition, CMS will learn more about the effects of the DRA provisions through work on proposed rules for the physician fee schedule and the prospective payment system for outpatient hospital care to be published in the summer of 2006.

The remaining factor in the 2007 SGR—the change in fee-for-service enrollment—is the least certain. CMS assumes a decrease of 2.9 percent. This figure differs from CBO's enrollment projection, which is an increase in fee-for-service enrollment of 0.3 percent for fiscal year 2007. CMS and CBO projections of total Medicare Part B enrollment are similar (1.5 percent and 1.8 percent, respectively), so the difference in the fee-for-service projections is due to the size of the shift in enrollment from Medicare fee-for-service to Medicare Advantage (MA). CMS may be better able to project any such shift when MA plans submit bids and identify market areas in June 2006. CMS can then revise the enrollment projection, if necessary, before the update becomes final in November 2006. Even then, CMS will have limited information on changes in enrollment in 2007, but the agency will have another two years to revise the enrollment estimate if better data become available, just as the agency does with changes in spending due to law and regulation.

The only remaining issue concerns CMS's estimates of actual spending for 2005 and 2006. Data on actual spending are nearly complete through the first three quarters of 2005 but are less complete for the last quarter of that year. Therefore, the estimate of actual spending in 2005 may increase or decrease somewhat before CMS issues a final rule on the update in November 2006. Of course, the uncertainty regarding 2006 estimates is greater than for 2005 because CMS currently has very little information on actual spending for 2006.

Regardless of what happens with the various estimates that determine the physician update, it is very unlikely that any change in them will overcome an update adjustment factor of –28.0 percent. For this reason, we anticipate that CMS will revise the update calculations this fall, in preparation for implementing the 2007 update on January 1, and that the calculations will show the maximum reduction that the statute permits: the change in input prices reduced by an update adjustment of –7.0 percentage points. ■

Endnotes

1 To illustrate the preliminary nature of CMS's estimate, note that last year the initial estimate of spending growth in 2004 was 15.2 percent. Since then, the agency has substantially revised the estimate downward to 11.4 percent.

2 The Commission recommended an update for 2007 equal to the projected change in input prices less an expectation for productivity growth (MedPAC 2006).

3 For the SGR, physician services include services commonly performed by a physician or performed in a physician's office. In addition to physician fee schedule services, these services include diagnostic laboratory tests and most of the drugs covered under Medicare Part B. To estimate this factor, CMS uses a weighted average of the MEI, a measure of changes in input prices for physician services, the change in payment rates for laboratory services legislated by the Congress, and a weighted average of the change in payment rates for Part B-covered drugs. The MEI is the change in input prices for physician services less an adjustment for productivity growth.

4 As required by the MMA, the real GDP per capita factor in the SGR is a 10-year moving average.

5 For the update, physician services include only those services in the physician fee schedule.

6 Historical changes in the MEI are published by the CMS Office of the Actuary (2006). Since 1991, they have ranged from 2.0 percent to 3.2 percent.

7 For further discussion of changes in spending due to law and regulation, see MedPAC's *Report to the Congress: Growth in the volume of physician services* (2004).

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