



## New Medicare Benefit Will Outspend Projections

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By Michael F. Cannon

The new cost projections for the upcoming **Medicare prescription drug entitlement** ([search](#)) are slightly higher this year than last year.

Democrats are making hay, while the Bush administration claims the projections are “virtually unchanged.”

What’s being ignored is that the actual cost of this new entitlement will likely exceed all current projections. Medicare and other entitlements have a history of spending more than projected. It’s in their nature.

When Medicare was enacted in 1965, official government projections foresaw hospital spending — the program’s largest component — reaching only \$9 billion in 1990. Actual Medicare spending on hospital care in that year was \$66 billion, or over seven times as high. One result is that Medicare’s payroll tax is now nearly double what its sponsors said would be necessary (having been raised most recently in 1994), and Congress increasingly relies on other revenue sources to meet Medicare’s obligations.

There are three principal reasons why we can expect this new entitlement to cost more than the government predicts.

### **Reason 1: Politicians don’t like to reveal how much of your money they are spending.**

A politician who hides the true cost of his proposal can give away more of your goodies without you taking notice (or at least not until it’s too late). A 2002 study in the *Journal of the American Planning Association* examining 258 transportation infrastructure projects found that politicians underestimated costs nine times out of 10, and that cost overruns averaged 28 percent.

“Cost underestimation cannot be explained by error,” the authors concluded, “and seems to be best explained by strategic misrepresentation, i.e., lying.”

One way to underestimate costs is with overly optimistic economic assumptions, which have a long pedigree under Medicare. President Lyndon Johnson’s administration was accused of hiding the true cost of Medicare by using rosy economic scenarios. Today, Medicare’s actuaries assume that health care costs will grow only one percentage point faster than GDP, even though the gap has historically been over twice as large.

Another way of low-balling costs is by “inflating the denominator.” In 2003, Congress and the president agreed to create a drug benefit that cost no more than \$400 billion over 10 years. Most understood this to mean an average of \$40 billion per year. But pushing the entitlement’s start date back to 2006 effectively spread an eight-year cost estimate over ten years, and made the projected cost appear 20 percent smaller.

There’s also what we might call “the Nixonian way.” During five months of legislative debate, the Bush administration concealed its own projections that the legislation would actually cost between \$500 billion and \$600 billion. At the same time senior administration officials claimed – on television and in newspapers – that the program would cost only \$400 billion, one such official threatened to fire Medicare’s chief

actuary if the actuary went public with the higher cost estimate.

### **Reason 2: People alter their behavior to maximize their entitlement.**

Medicare spending exceeded initial projections because seniors consumed more care when they bore less of the cost. Once taxpayers subsidize seniors' consumption of prescription drugs, seniors will consume more drugs than they did before.

Many will drop the drug coverage they already have to take advantage of the new entitlement. The Congressional Budget Office estimates that every fourth participant in the new entitlement would have had private drug coverage anyway.

Congress was so worried that employers will drop their retirees into the new program that it will begin bribing employers not to do so — to the tune of about \$5 billion per year.

Actual spending on employer subsidies will probably be larger, as employer groups manufacture ways to qualify for the subsidy. These behavioral changes will leave taxpayers paying for costs that someone else was already paying voluntarily.

### **Reason 3: Congress often expands the entitlement.**

Cost projections cannot predict future changes in legislation. Once a program is in place, beneficiaries lobby Congress to expand it. The Medicare drug benefit came about under political pressure from Medicare beneficiaries for greater subsidies. The same has happened with Social Security. Once the drug benefit takes effect, expect to hear pleas from seniors for further subsidies to fill in the infamous “doughnut hole.”

Just how expensive the new Medicare prescription drug entitlement will be is impossible to say. Jagadeesh Gokhale of the Cato Institute and Joe Antos of the American Enterprise Institute posit that the actual cost could be over twice as high as current projections. They may be wrong, but if history is any guide, they're definitely in the right neighborhood.

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