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MEDICARE IS NOT “BANKRUPT” Health Reform Has Improved Program’s Financing

By Paul N. Van de Water

Claims by some policymakers that the Medicare program is nearing “bankruptcy” are misleading. Although Medicare faces major financing challenges, the program is not on the verge of bankruptcy or ceasing to operate. Such charges represent misunderstanding (or misrepresentation) of Medicare’s finances.

Medicare’s financing challenges would be significantly greater without the health reform law (the Affordable Care Act, or ACA), which substantially improved the program’s financial outlook. Repealing the Affordable Care Act, a course of action promoted by some who simultaneously claim that the program is approaching “bankruptcy,” would make Medicare’s financial situation much worse.

The 2011 report of Medicare’s trustees finds that Medicare’s Hospital Insurance (HI) trust fund will remain solvent — that is, able to pay 100 percent of the costs of the hospital insurance coverage that Medicare provides — through 2024; at that point, the payroll taxes and other revenue deposited in the trust fund will still be sufficient to pay 90 percent of Medicare hospital insurance costs.¹ (The Medicare hospital insurance program is considered insolvent when revenues and trust fund balances will not cover 100 percent of projected costs.) Over the next 75 years, revenue will cover an average of 83 percent of Medicare’s hospital insurance costs. This shortfall will need to be closed through the provision of additional revenues, program changes that slow the growth in costs, or most likely both. But the Medicare hospital insurance will not run out of all financial resources and cease to operate after 2024, as the “bankruptcy” term may suggest.

The 2024 date does not apply to Medicare coverage for physician and outpatient costs or to the Medicare prescription drug benefit; these parts of Medicare do not face insolvency and cannot run short of funds. These parts of Medicare are financed through the program’s Supplementary Medical Insurance (SMI) trust fund, which consists of two separate accounts — one for Medicare Part B, which pays for physician and other outpatient health services, and one for Part D, which pays for outpatient prescription drugs. Premiums for Part B and Part D are set each year

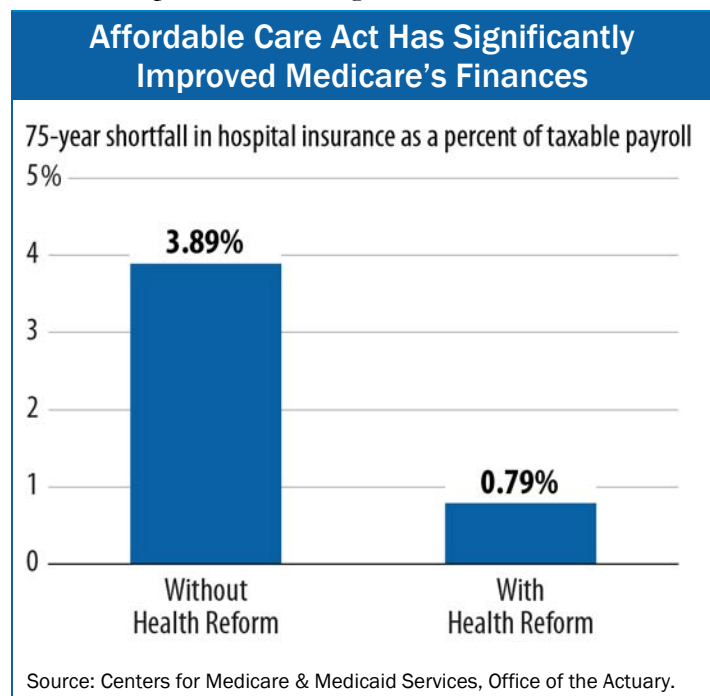
¹ Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds, *2011 Annual Report*, May 13, 2011.

at levels that cover 25 percent of costs; general revenues pay the remaining 75 percent of costs.² The trustees' report does not project that these parts of Medicare will become insolvent at any point — because they can't. The SMI trust fund always has sufficient financing to cover Part B and Part D costs, because the beneficiary premiums and general revenue contributions are specifically set at levels to assure this is the case. SMI cannot go “bankrupt.”

Nonetheless, Medicare faces serious financing challenges in order to make the Hospital Insurance trust fund solvent over the long term and to reduce unsustainable federal budget deficits that are driven in part by Medicare's rising costs. Major reforms in health care payment and delivery will be essential throughout the U.S. health care system, and Medicare will need to play an important role in leading the way to those reforms. A first step, however, should be to “do not harm” — that is, not make Medicare's financing challenges even greater. Repealing the Affordable Care Act would do exactly that.

The Affordable Care Act has significantly improved Medicare's long-term financial outlook. Under the trustees' main projection, the Medicare hospital insurance program faces a shortfall over the next 75 years equal to 0.79 percent of taxable payroll — that is, 0.79 percent of the total amount of earnings that will be subject to the Medicare payroll tax over this period. The Medicare actuary estimates that if health reform were repealed, HI's long-term shortfall would increase from 0.79 percent to 3.89 percent of taxable payroll (see figure).³ Under that analysis, health reform has reduced the size of HI's shortfall by four-fifths. In the absence of the ACA, the Medicare hospital insurance program would become insolvent eight years earlier, in 2016, and the costs of SMI would be significantly higher and rise more rapidly in the years ahead.

These projections underscore the importance of successfully implementing the cost-control provisions in the Affordable Care Act. While history shows that most major Medicare savings measures have been implemented as scheduled, the Medicare actuary has expressed concern that some of the ACA's savings provisions may not be sustainable. The actuary urges reliance instead on an “illustrative alternative” projection for Medicare, which assumes that only 60 percent of the ACA's Medicare savings will actually be achieved in the long run. Under this alternative projection, the projected insolvency date of the Hospital Insurance trust fund remains at 2024, but the 75-year shortfall in the fund would rise to



² Medicare also subsidizes the Part D premiums of low-income enrollees.

³ Office of the Actuary, Centers for Medicare & Medicaid Services, Memorandum to the Subcommittee on Health, House Committee on Ways and Means, June 21, 2011.

Arbitrary 45-Percent General-Revenue Threshold Bears No Relationship to Medicare's Financial Health

The Medicare Modernization Act of 2003 (P.L. 108-173) requires the trustees to issue a “Medicare funding warning” when the overall share of Medicare’s financing that comes from general revenue (for all parts of Medicare combined) is projected to exceed 45 percent. The trustees project that this level will be exceeded in 2011 and 2012. The 45-percent level, however, is an arbitrary benchmark that is unrelated to the program’s financial health.

By design, Parts B and D of Medicare are supposed to be financed in large part with general revenues. That at least 45 percent of Medicare will be financed with general revenues is no more a problem than that 100 percent of defense, education, or most other federal programs is financed with general revenues.

2.15 percent of payroll, about 2¾ times higher than the trustees’ official estimate. This still is a dramatic improvement, however, over the outlook *without* the Affordable Care Act.

The trustees’ latest projections, issued in May, are broadly in line with those that the trustees have issued for some time. They do not represent a striking change in Medicare’s finances. Since 1990, changes in the law, the economy, and other factors have brought the projected year of Medicare HI insolvency as close as four years away or pushed it as far as 28 years into the future. The latest projection falls near the middle of that spectrum. Trustees’ reports have been projecting impending insolvency for four decades, but Medicare benefits have always been paid because Congress has taken steps to keep spending and resources in balance in the near term. In contrast to Social Security, which has had no major changes in law since 1983, the rapid evolution of the health care system has required frequent adjustments to Medicare, a pattern that is certain to continue.

Despite the financial improvements the Affordable Care Act makes, Medicare continues to face substantial long-term financial challenges, stemming from the aging of the population and the continued rise in costs throughout the U.S. health care system. The projected increase in long-term Medicare costs also contributes heavily to the bleak federal fiscal outlook. It is essential that policymakers take further substantial steps to curb the growth of health costs throughout the U.S. health care system as we learn more about how to do so effectively in both public programs and private-sector health care. The Medicare research and pilot projects that the ACA establishes should yield important lessons.

In the near term — before these efforts bear fruit— it will be difficult to achieve big additional reductions in Medicare expenditures (although some more modest savings should be achievable), without shifting substantial costs to beneficiaries or greatly reducing payments to providers, either of which would likely endanger access to care for low- and moderate-income beneficiaries. Extending the life of the HI trust fund will almost certainly require *both* reductions in projected HI expenditures *and* increases in HI revenues.

Phasing out traditional Medicare and replacing it with private health insurance, as the House-passed budget resolution would do, would represent a big step in the wrong direction. It would *increase* total health care spending attributable to Medicare beneficiaries — the

beneficiaries' share plus the government's share — by upwards of 40 percent.⁴ The Congressional Budget Office (CBO) estimates that in 2022 (the first year the new arrangement would be in effect), the plan would cause total health spending attributable to the average 65-year-old Medicare beneficiary to increase from \$14,750 to \$20,500. The plan would also reduce the federal government's contribution to cover those costs. As a result, it would massively shift costs to the beneficiaries — that is, the elderly and people with disabilities. According to CBO, the average 65-year-old beneficiary's out-of-pocket costs would more than double, from \$6,150 a year under a continuation of traditional Medicare to \$12,500 under the House plan.⁵

Traditional Medicare — rather than private health insurance — has been the leader in instituting various reforms in the health care payment system to improve efficiency and constrain costs. These include the prospective payment system for hospitals and Medicare's fee schedule for physicians. Partly because of its record of innovation, Medicare has outperformed private insurance in holding down the growth of health costs. Between 1970 and 2009, Medicare spending per enrollee grew by an average of 1 percentage point less each year than comparable private health insurance premiums.⁶

Health reform envisions that Medicare will continue to lead the way in efforts to slow health care costs while improving the quality of care. By eliminating traditional Medicare, the House-passed budget plan would discard the opportunity to use the program to promote cost reduction throughout the health care system. This makes it all the more important that policymakers and the American public not be driven into adopting such a radical proposal by misleading claims that Medicare is on the verge of “bankruptcy.”

⁴ Douglas W. Elmendorf, Director, Congressional Budget Office, Letter to the Honorable Paul Ryan, April 5, 2011, and CBPP calculations.

⁵ Paul N. Van de Water, *Converting Medicare to Premium Support Would Likely Lead to Two-Tier Health Care System*, Center on Budget and Policy Priorities, forthcoming, July 2011.

⁶ Centers for Medicare & Medicaid Services, *National Health Expenditure Web Tables*, January 2011, table 13.