THE HENRY J. KAISER FAMILY FOUNDATION

FACT SHEET

MEDICARE

MEDICARE SPENDING AND FINANCING

April 2005

Overview

Medicare is a federal health insurance program for 42 million elderly and disabled Americans, providing coverage primarily for acute and post-acute care. Beginning in 2006, Medicare will also include an outpatient prescription drug benefit. Medicare consists of four parts: Part A for Hospital Insurance (HI), Part B for Supplementary Medical Insurance (SMI), Part C for Medicare Advantage (private health care plans), and Part D for the new prescription drug benefit.

Overview of Medicare Spending

Medicare spending is a large component of both the federal budget and national health spending. In 2004:

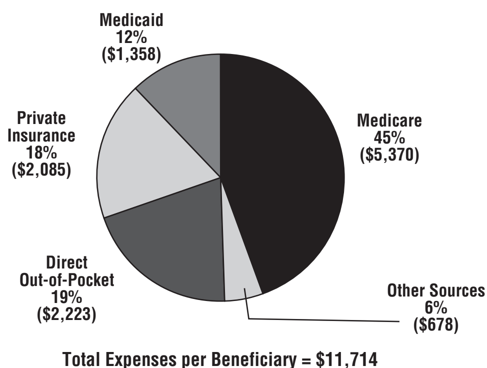
- Net federal spending on Medicare was $265 billion, 12% of federal spending (OMB, 2005).
- Spending on Medicare benefits was 17% of the nation's total health care spending of $1.8 trillion (CMS OACT, 2005).

Each year, a majority of beneficiaries use Medicare to help pay for their hospital, physician, or other medical care. In 2002, Medicare paid less than half of the $11,714 in total medical expenses per beneficiary (excluding Medicare and private insurance premiums and deductibles), while beneficiaries paid 19% out of pocket. Out-of-pocket spending consisted largely of long-term care (36%), prescription drugs (22%), and provider visits and medical supplies (21%).

Medicare beneficiaries tend to be sicker than non-elderly people and use more medical services. Spending per beneficiary is highly skewed, with a small share of beneficiaries (12%) accounting for a large share of total Medicare spending (69%), and a disproportionate share of spending occurring in the last year of life. Although spending is higher for people with Medicare than for people with private health insurance on a per capita basis, growth in annual spending per Medicare enrollee since the program's inception has been approximately one percentage point lower than private health insurance spending.

Figure 1

Sources of Payment for Medicare Beneficiaries' Medical and Long-Term Care Services, 2002

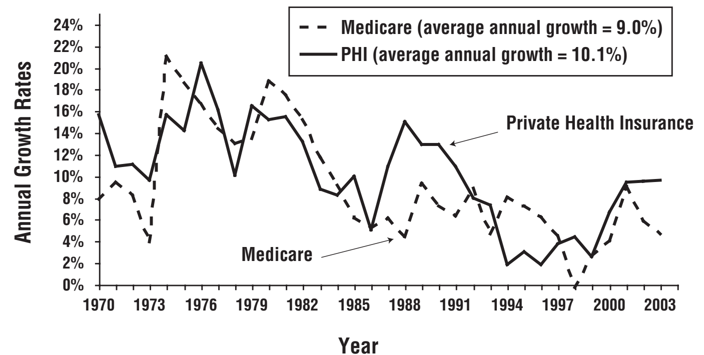


Total Expenses per Beneficiary = $11,714

Note: Pie shows average total spending for both noninstitutionalized and institutionalized beneficiaries, including long-term care, skilled nursing facility, and prescription drug spending, but excluding spending on premiums or deductibles for Medicare Parts A, B, and C and private health insurance.
SOURCE: Kaiser Family Foundation Analysis of the 2002 Medicare Current Beneficiary Survey Cost & Use file.

Figure 2

Annual Percentage Change in Medicare and Private Health Insurance Spending, 1970–2003



SOURCE: Centers for Medicare and Medicaid Services, Office of the Actuary, National Health Statistics Group, 2004.

Annual growth in Medicare spending is largely influenced by the same factors that affect health spending in general: increasing prices of health care services, increasing volume and utilization of services, and expensive new technologies. Over the years, provider payment reforms, such as the hospital prospective payment system, have helped to limit the growth in Medicare spending. Policymakers also introduced managed care into Medicare, although this has generally not produced savings. Annual increases in health care costs will continue to place upward pressure on Medicare spending, as for other payers.

Medicare Spending and the New Drug Benefit

The new prescription drug benefit, beginning in 2006, will contribute to increased federal spending on Medicare. Between 2006 and 2015, the Administration estimates the net federal cost of the Medicare drug benefit to be $724 billion. After a one-time increase in Medicare spending of 27.8% between 2005 and 2006 due to the addition of the drug benefit, program spending is projected to grow annually by 7.3% between 2006 and 2014, which is in line with the projected 6.8% annual growth in private health insurance payments over the same period (CMS OACT, 2005).

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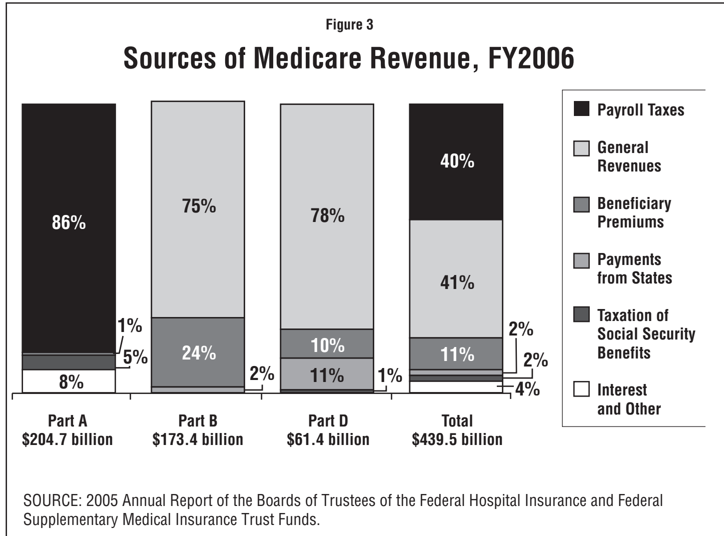
How is Medicare Financed?

Funding for Medicare comes primarily from payroll tax revenues, general revenues, and premiums paid by beneficiaries. Medicare is funded as follows:

- **Part A** is financed largely through a dedicated tax of 2.9% of earnings paid by employers and their employees (1.45% each).
- **Part B** is financed through a combination of general revenues and premiums paid by beneficiaries.
- **Part D** is financed through beneficiary premiums (set at 25.5% of the cost of the standard drug benefit), general revenues, and state payments for dual eligibles.

Figure 3

Sources of Medicare Revenue, FY2006



SOURCE: 2005 Annual Report of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds.

Measuring Medicare's Fiscal Health

Medicare spending can be measured in a number of ways, including absolute dollars, percent of the gross domestic product, and percent of national health expenditures. Future Medicare spending is expected to represent a growing share of the economy as well as the nation's total health spending.

Medicare's financial health is reflected in the status of Medicare's HI and SMI trust funds, assessed each year by the Medicare Board of Trustees. According to the 2005 Trustees' report, spending of HI trust fund assets is projected to exceed income beginning in 2012; the HI trust fund reserves are projected to be exhausted in 2020. SMI trust fund assets are projected to be adequate because each year, beneficiary premiums and general revenue contributions are set to match expected outlays for Part B and Part D.

The Medicare Modernization Act of 2003 (MMA) established a new way of assessing Medicare's financial status, by looking at general revenues as a share of total Medicare spending. The Board of Trustees will report annually whether general revenues are projected to finance 45% or more of Medicare spending in any of the next seven years. If so, a determination of "excess general funding" is made. If this determination is made two years in a row, a "Medicare funding warning" is issued. The President is required to submit to Congress proposed legislation to respond to the warning, with congressional consideration of this legislation to occur on an expedited basis.

Figure 4

Measures of Medicare Spending, 2005–2014

	2005	2006	2010	2012	2014
Spending as % of Gross Domestic Product*	2.7%	3.3%	3.5%	3.7%	4.0%
Spending as % of National Health Expenditures**	17.2%	20.4%	20.2%	20.3%	20.8%
Years to HI Trust Fund Depletion* (2005 projections)	15 years	14 years	10 years	8 years	6 years
General Revenue as a Share of Total Medicare Spending*	36.8%	42.8%	44.5%	45.6%	47.9%

SOURCE: *2005 Annual Report of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds. **Centers for Medicare and Medicaid Services, Office of the Actuary, National Health Statistics Group, February 2005.

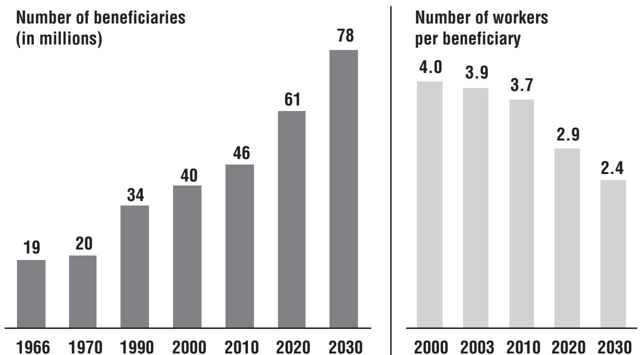
In 2005, the Medicare Trustees projected that general revenues will first exceed 45% of total Medicare spending in 2012. A substantial increase in general revenues needed to pay for Medicare is attributable to the financing of the new prescription drug benefit.

Future Challenges

Over the longer term, the aging of the baby-boom generation, a decline in the number of workers per beneficiary, and increasing life expectancy will present fiscal challenges for Medicare. From 2000 to 2030, the number of people on Medicare is projected to rise from 40 million to 78 million, while the number of workers to support beneficiaries is projected to decline from 4.0 workers per beneficiary to 2.4 workers per beneficiary.

Figure 5

Historical and Projected Number of Medicare Beneficiaries and Number of Workers per Beneficiary



SOURCE: 2001 and 2005 Annual Reports of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds.

Medicare provides essential coverage for its beneficiaries and enjoys broad public support. How to ensure the program's financial stability over the long term while meeting the health care needs of an aging population is a pressing challenge.

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