THE HENRY J. KAISER FAMILY FOUNDATION

FACT SHEET

MEDICARE

MEDICARE SPENDING AND FINANCING

September 2008

OVERVIEW OF MEDICARE SPENDING

Medicare is a federal health insurance program for nearly 45 million elderly and disabled Americans, helping pay for hospital and physician visits, prescription drugs, and other acute and post-acute services. Spending on Medicare represents 14% of federal spending. Medicare accounts for 22% of national health spending, varying by type of service: 38% of home health care, 29% of hospital services, and 21% of physician services (Figure 1). Implementation of the Medicare drug benefit in 2006 increased Medicare's share of total national prescription drug spending from 2% in 2005 to 18% in 2006.

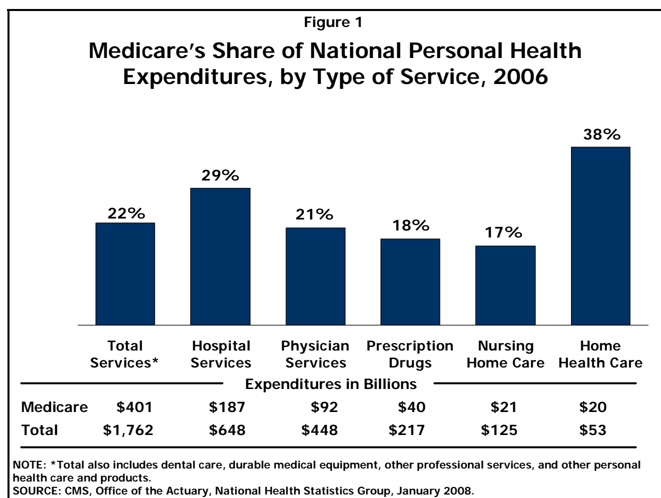


Figure 1
Medicare's Share of National Personal Health Expenditures, by Type of Service, 2006

Expenditures in Billions	Total Services*	Hospital Services	Physician Services	Prescription Drugs	Nursing Home Care	Home Health Care
Medicare	$401	$187	$92	$40	$21	$20
Total	$1,762	$648	$448	$217	$125	$53

NOTE: *Total also includes dental care, durable medical equipment, other professional services, and other personal health care and products.
SOURCE: CMS, Office of the Actuary, National Health Statistics Group, January 2008.

In 2007, benefit payments for the four parts of Medicare totaled $426 billion (Figure 2):

- Part A – Hospital Insurance (HI) = 41% (including home health which is partially funded under Part B)
- Part B – Supplementary Medical Insurance (SMI) = 28%
- Part C – Medicare Advantage (private health plans) = 18%
- Part D – Prescription drug benefit = 12%

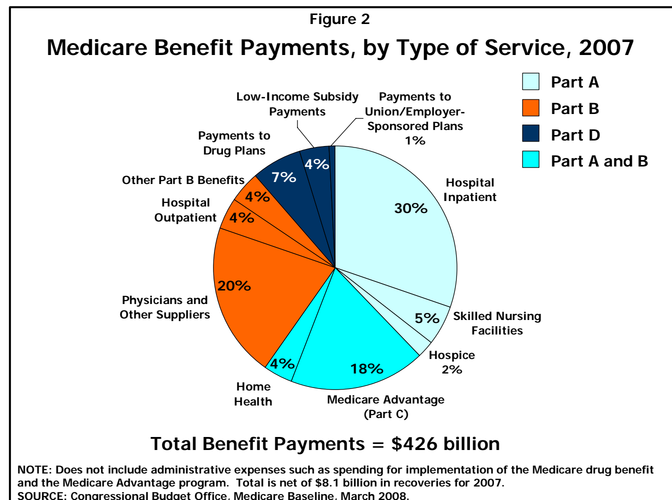


Figure 2
Medicare Benefit Payments, by Type of Service, 2007

Total Benefit Payments = $426 billion

NOTE: Does not include administrative expenses such as spending for implementation of the Medicare drug benefit and the Medicare Advantage program. Total is net of $8.1 billion in recoveries for 2007.
SOURCE: Congressional Budget Office, Medicare Baseline, March 2008.

MEDICARE SPENDING ON MEDICAL AND LONG-TERM CARE

In 2005, Medicare paid just under half of the $14,471 in average total medical and long-term care expenses per beneficiary in traditional fee-for-service (FFS) Medicare (Figure 3). Beneficiaries themselves paid just over $2,500 (17%) out of pocket, excluding premiums. Beneficiaries' average out-of-pocket spending in 2005 consisted primarily of long-term care (31%), prescription drugs (25%), and provider visits/medical supplies (25%).

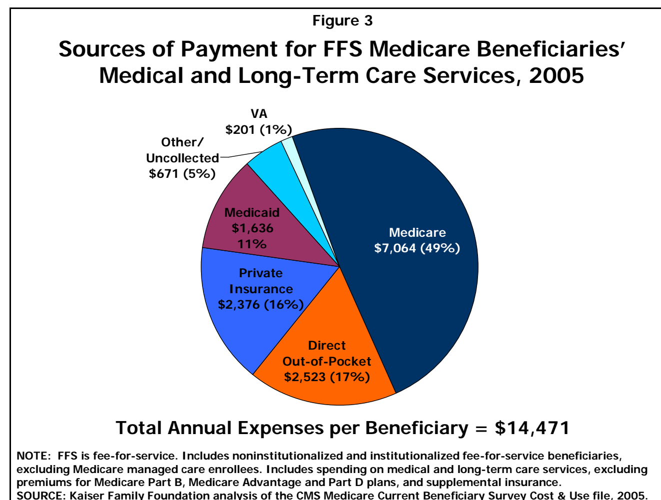


Figure 3
Sources of Payment for FFS Medicare Beneficiaries' Medical and Long-Term Care Services, 2005

Total Annual Expenses per Beneficiary = $14,471

NOTE: FFS is fee-for-service. Includes noninstitutionalized and institutionalized fee-for-service beneficiaries, excluding Medicare managed care enrollees. Includes spending on medical and long-term care services, excluding premiums for Medicare Part B, Medicare Advantage and Part D plans, and supplemental insurance.
SOURCE: Kaiser Family Foundation analysis of the CMS Medicare Current Beneficiary Survey Cost & Use file, 2005.

Medicare spending per beneficiary varies, with the top 10% most costly beneficiaries in FFS Medicare accounting for nearly two-thirds (63%) of total Medicare spending in 2005 (Figure 4). Average Medicare spending for the 4% of FFS beneficiaries who died within the calendar year in 2005 was nearly four times greater than for other beneficiaries ($23,047 vs. $6,351).

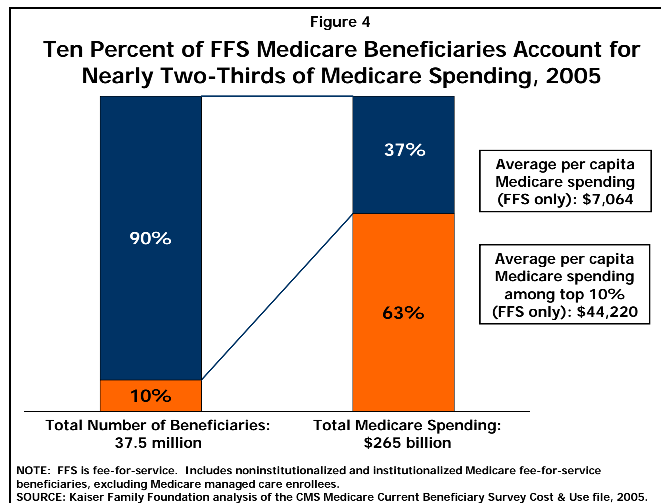


Figure 4
Ten Percent of FFS Medicare Beneficiaries Account for Nearly Two-Thirds of Medicare Spending, 2005

NOTE: FFS is fee-for-service. Includes noninstitutionalized and institutionalized Medicare fee-for-service beneficiaries, excluding Medicare managed care enrollees.
SOURCE: Kaiser Family Foundation analysis of the CMS Medicare Current Beneficiary Survey Cost & Use file, 2005.

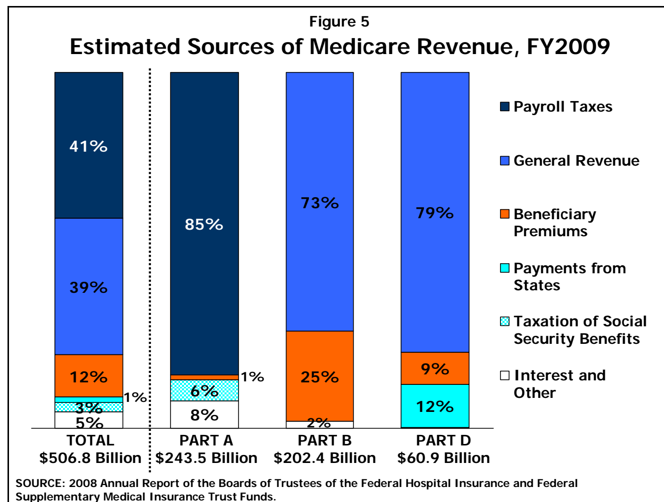
HOW IS MEDICARE FINANCED?

Medicare is funded primarily from three sources: payroll tax contributions (41%), general revenues (39%), and beneficiary premiums (12%) (Figure 5). Medicare Parts A, B, and D are financed separately, as follows:

- Part A: financed largely through a 2.9% tax on earnings paid by employers and employees (1.45% each) (85%)
- Part B: financed through general revenues (73%) and beneficiary premiums (25%)
- Part D: financed through general revenues (79%), state payments for dual eligibles (12%), and beneficiary premiums (9%)

Figure 5

Estimated Sources of Medicare Revenue, FY2009



SOURCE: 2008 Annual Report of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds.

MEASURING MEDICARE'S FINANCIAL CONDITION

Medicare's financial condition is measured in a number of ways, including spending as a percent of the gross domestic product, the federal budget, and national health expenditures (Figure 6). Over time, Medicare spending is projected to represent a growing share of the economy, federal spending, and the nation's total health spending.

Medicare's financial health is also measured in the status of Medicare's HI and SMI trust funds, assessed each year by the Medicare Board of Trustees. According to the 2008 Trustees' report, spending of HI trust fund assets is projected to exceed income beginning in 2010; the HI trust fund reserves are projected to be exhausted in 2019. SMI trust fund assets are projected to be adequate because beneficiary premiums and general revenue contributions are set to match expected outlays for Part B and Part D each year.

In 2008, for the third year in a row, the Medicare Trustees projected that general revenues will exceed 45% of total Medicare spending within a seven-year timeframe (by 2014), prompting them to issue a "Medicare funding warning", which requires the President to submit legislation in response and Congress to consider this legislation on an expedited basis. The Administration's proposal, the "Medicare Funding Warning Response Act of 2008", would implement a national system of electronic medical records and a provider pay-for-performance system in Medicare; provide cost and quality information to Medicare beneficiaries; amend the medical malpractice liability system to include a statute of limitations and limits to recovery of non-economic and punitive damages; and establish an income-related premium for Part D. In July 2008, the House of Representatives voted to suspend consideration of this legislation for the remainder of the year.

Figure 6

Alternative Measures of Medicare Spending, 2008-2017

	2008	2009	2010	2014	2017
Spending as % of Gross Domestic Product*	3.2%	3.3%	3.3%	3.6%	4.0%
Spending as % of National Health Expenditures**	19.2%	19.4%	19.5%	20.0%	20.7%
Years to HI Trust Fund Depletion* *(2008 projections)*	11 years	10 years	9 years	5 years	2 years
General Revenue as a Share of Total Medicare Spending*	40.6%	41.4%	41.9%	45.3%	48.5%

SOURCES: *2008 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 2008.

FUTURE CHALLENGES

Sustained increases in health care costs are placing upward pressure on Medicare spending, as for other payers. Medicare spending is projected to grow annually by 7.5% between 2008 and 2017 (CMS OACT, 2008), compared to an average annual growth rate of 6.2% for private health insurance spending over the same time period. 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 new technologies. In the past, provider payment reforms, such as the hospital prospective payment system, have helped to limit the growth in Medicare spending. Moving forward, system-wide efforts to curtail overall health care costs would help to improve Medicare's financial outlook.

Over the longer term, an aging population, a decline in the number of workers per beneficiary, and increasing life expectancy will present fiscal challenges for Medicare. From 2010 to 2030, the number of people on Medicare is projected to rise from 46 million to 78 million, while the number of workers to support beneficiaries is projected to decline from 3.7 workers per beneficiary to 2.4 workers per beneficiary.

Medicare provides essential coverage for its beneficiaries and enjoys broad public support. How to ensure the program's financial stability over the long term without shifting excessive costs onto beneficiaries, while meeting the health care needs of an aging population, is a pressing challenge for the nation.

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