Section 7

Medicare Financing and Future Projections

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Medicare Parts A and B are financed differently. Part A, paid through the Hospital Insurance (HI) Trust Fund, is financed primarily through a 1.45 percent payroll tax paid by both employees and their employers. In 2006, these taxes will account for 86 percent of income to the Part A Trust Fund, with the remainder coming from interest, taxation of Social Security benefits, and other sources. Part B is financed through the Supplementary Medical Insurance (SMI) Trust Fund and funded by general revenue (75 percent in 2006), beneficiary premiums (24 percent), and interest (2 percent).

Part D, Medicare's new prescription drug benefit, is financed through a separate account within the SMI Trust Fund. When the benefit takes effect in 2006, it will be financed through general revenue (78 percent), payments from states (11 percent), beneficiary premiums (10 percent), and other sources (1 percent). The payments from states (known as the "clawback") are meant to partially cover the costs of low-income Medicare beneficiaries previously eligible for prescription drug benefits under state Medicaid programs.

In FY2006, total Medicare revenues are projected to be $439.5 billion. These funds will come from general revenue (41 percent), payroll taxes (40 percent), beneficiary premiums (11 percent), interest (4 percent), taxation of Social Security benefits (2 percent), and other sources (2 percent). The share of Medicare revenue from payroll taxes, the largest source of income to the Medicare trust funds in 2004, has decreased since the early 1970s, largely as a result of faster growth in Part B expenditures, which are not funded by the payroll tax. General revenue accounted for almost one-third of total Medicare revenue in 2004, but will represent a larger share in the future.

As part of an annual assessment of Medicare's financial outlook, the Boards of Trustees of Medicare issue a report on the current and projected status of the program, including the HI and SMI Trust Funds. Since Medicare's implementation, the primary sources of income for Part B (the SMI Trust Fund)—premiums and general revenues—have been set each year at a level sufficient to pay benefits. Because the HI Trust Fund can theoretically become insolvent, its status has become a proxy for Medicare's overall financial health. In almost every year to date, total HI Trust Fund income has exceeded expenditures. While income from all sources is expected to exceed expenditures in the short run, spending will begin to exceed income in 2012, according to the Trustees' intermediate assumptions.

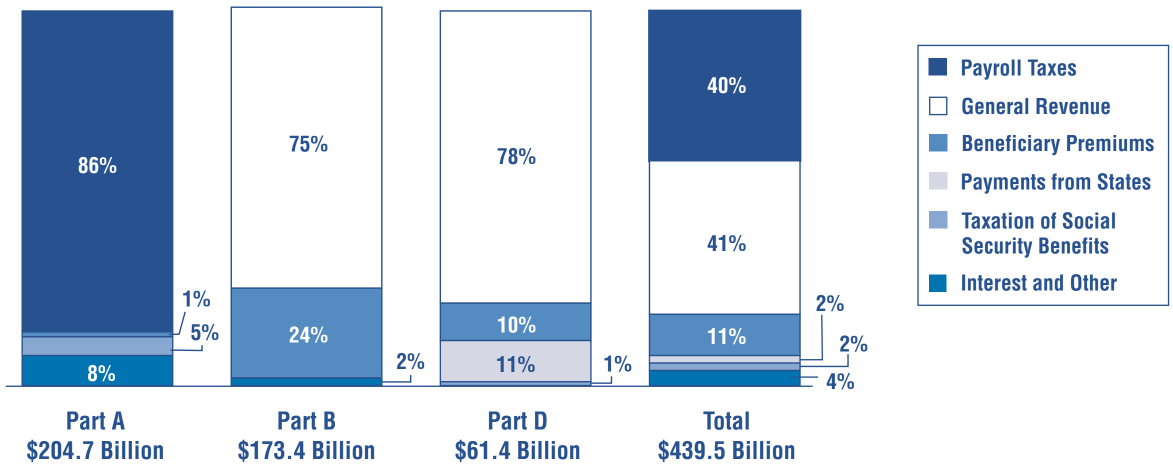
The Medicare Trustees also project how long the HI Trust Fund will remain solvent. In 2005, the Trustees projected that fund reserves will be exhausted and have insufficient funds to pay benefits in 2020. This projection varies from year to year due to changes in underlying economic conditions, expectations about future health care costs, and legislated changes in the Medicare program. For example, the number of years through which the Trustees have projected the HI Trust Fund to have sufficient funds to pay benefits has ranged from four to 28 over the last decade alone. In 2004, the solvency projection fell from 23 years to 15 years, due in part to the economic downturn and faster than expected expenditure growth, along with legislative changes to increase payments to Medicare Advantage plans and rural health providers (enacted as part of the Medicare Modernization Act of 2003).

The Medicare Modernization Act established a new process for reviewing the role of general revenue in financing Medicare. Beginning in 2005, the Medicare Boards of Trustees are required to report annually whether general revenue will finance 45 percent or more of Medicare spending in any of the next seven years. If the 45 percent level is projected to be reached, a determination of "excess general revenue" is triggered. If this determination is made two years in a row, a "Medicare funding warning" is issued, and the President must submit to Congress proposed legislation to respond to the warning. Congress then considers this legislation on an expedited basis. In 2005, the Trustees projected that general revenue financing will reach the 45 percent threshold in 2012. If this projection holds, the first “excess general revenue” determination would be made in 2006, and the Medicare funding warning and legislative process may be triggered as early as 2007.

Over the long term, Medicare will face significant financing challenges due to the aging of the U.S. population. The first of the “Baby Boom” generation will reach age 65 and become eligible for Medicare in 2010. Between 2000 and 2030, the number of Medicare beneficiaries is projected to almost double, from 40 million to 78 million. The aging of the population has significant implications for Medicare financing. Because the HI Trust Fund is financed primarily through payroll taxes, its income is directly related to the number of individuals in the workforce. The number of workers is projected to rise slower than the number of beneficiaries, thus increasing the implicit burden on each worker over the next generation. There were 3.9 workers per Medicare beneficiary in 2003, but there are projected to be only 2.4 workers per beneficiary in 2030.

With the aging of the population and expected increases in overall health care costs, largely due to new and more expensive medical technologies, Medicare spending is projected to grow at a rate significantly higher than that of the overall economy. Between 2000 and 2030, Medicare’s share of the overall economy, as measured by the gross domestic product (GDP), is estimated to triple from 2.3 percent to 6.8 percent. The addition of the prescription drug benefit to Medicare accounts for more than one-third of that increase.

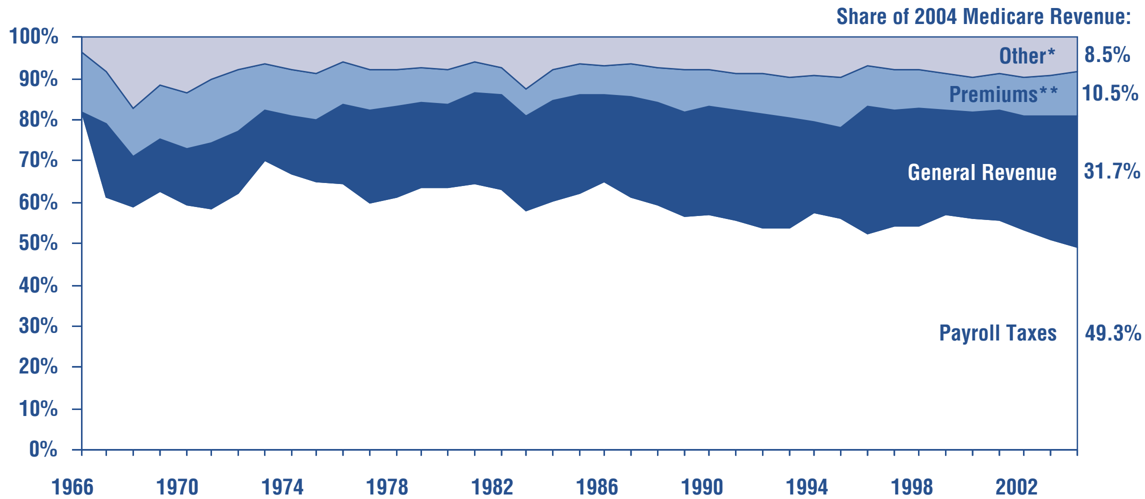
Figure 7.1
Sources of Medicare Revenue, FY2006



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

Medicare Parts A, B, and D (beginning in 2006) are financed differently. Payroll taxes finance the majority of Part A, while general revenues fund three-fourths of Parts B and D. In FY2006, total Medicare revenue is estimated to come largely from general revenue (41 percent), payroll taxes (40 percent), and beneficiary premiums (11 percent).

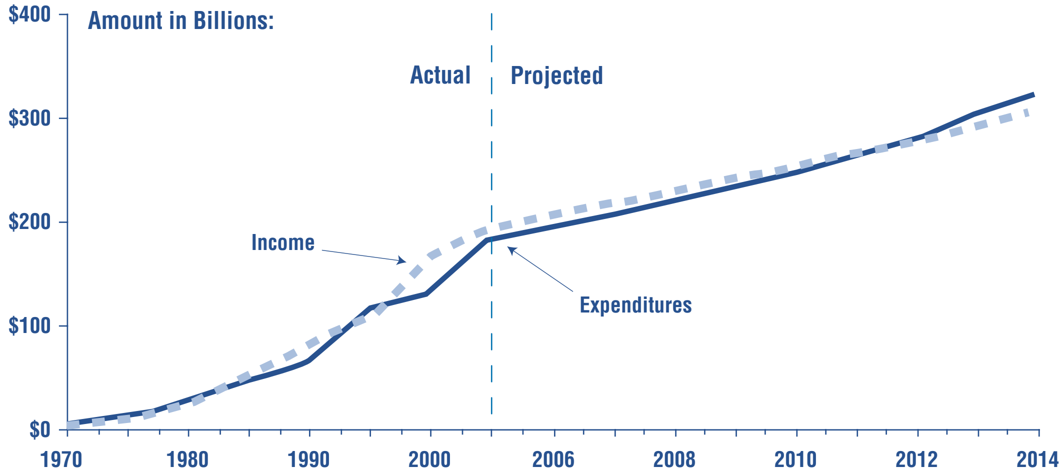
Figure 7.2
Income of the Hospital Insurance and Supplementary Medical Insurance Trust Funds, by Source, 1966–2004



Note: *Includes income from taxation of Social Security benefits, railroad retirement account transfers, reimbursement for uninsured persons, payments for military wage credits, recoveries of amounts reimbursed from the trust fund which are not obligations of the trust fund, amounts from the fraud and abuse control system, interest, and a small amount of miscellaneous income. **Includes premiums from voluntary enrollees in the Hospital Insurance Program and all enrollees in the Supplementary Medical Insurance Program.
SOURCE: Annual Reports of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds, various years.

Payroll taxes are the largest source of Medicare revenue, although they have decreased from about two-thirds of all revenue in the early 1970s to just under half in 2004. This has resulted from faster growth in Part B spending than Part A spending, which is funded primarily by general revenue (75 percent) and beneficiary premiums (25 percent). General revenue accounted for almost one-third of total Medicare revenue in 2004.

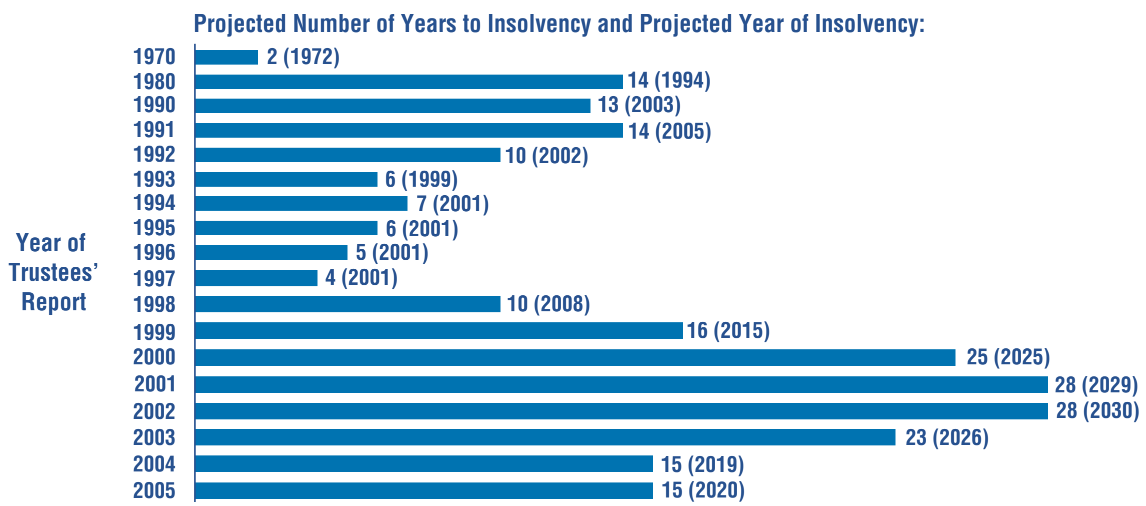
Figure 7.3
Operations of the Hospital Insurance Trust Fund, 1970–2014



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

In almost every year to date since Medicare's inception, total income to the Hospital Insurance Trust Fund has exceeded expenditures, except during the 1995–1997 period. While income from all sources is expected to exceed expenditures in the short run, spending will begin to exceed income in 2012, according to the intermediate assumptions made by the Medicare Trustees in 2005.

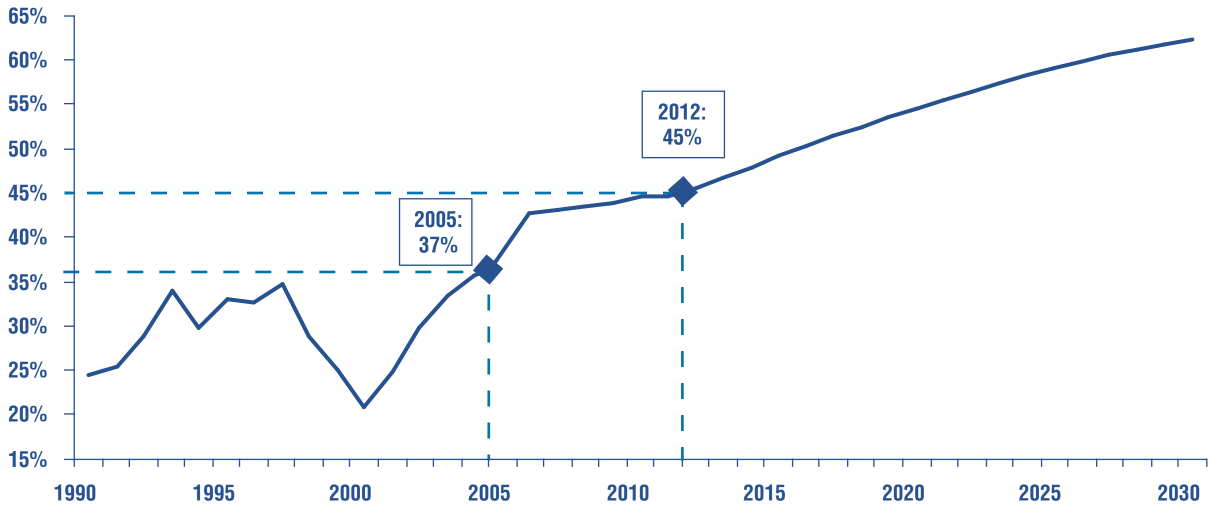
Figure 7.4
Solvency Projections of the Hospital Insurance Trust Fund, 1970–2005



Note: No specific projections were made for 1973–1975 and 1989. For all other years not displayed, the Hospital Insurance Trust Fund was projected to remain solvent for 17 or fewer years.
SOURCE: Intermediate projections from 1970–2005 Annual Reports of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds.

The Medicare Trustees' assessment of the financial outlook for the Medicare Hospital Insurance Trust Fund has varied significantly from year to year, with projections ranging from four years to 28 years of remaining solvency over the last decade alone. Between 2003 and 2005, the solvency projection fell from 23 years to 15 years, due in part to an economic downturn, faster than expected expenditure growth, and increased payments to Medicare Advantage plans and rural health providers.

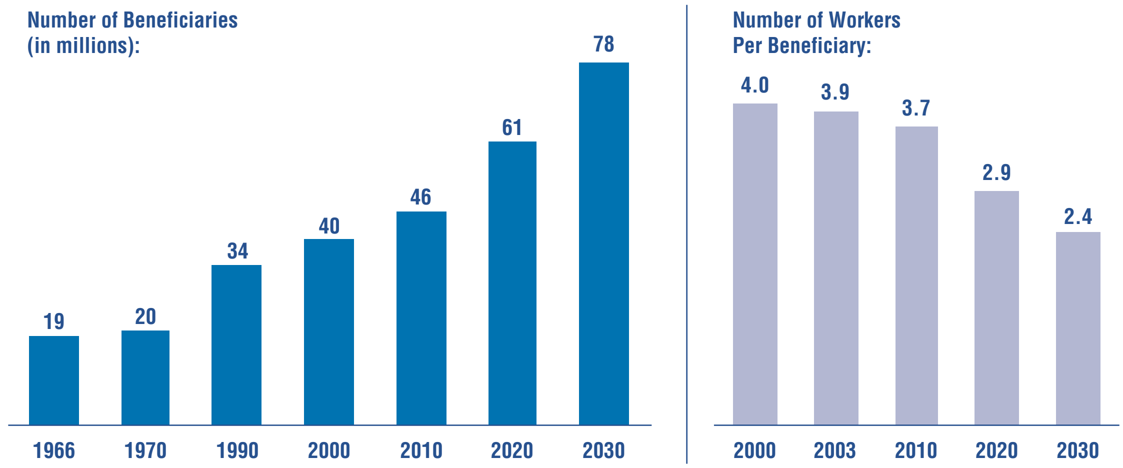
Figure 7.5
General Revenue as a Share of Medicare Spending, 1990–2030



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

The Medicare Trustees are required to report annually whether general revenue will finance 45 percent or more of total Medicare spending in any of the next seven years. In 2005, the Trustees projected that general revenue will exceed 45 percent of total spending in 2012.

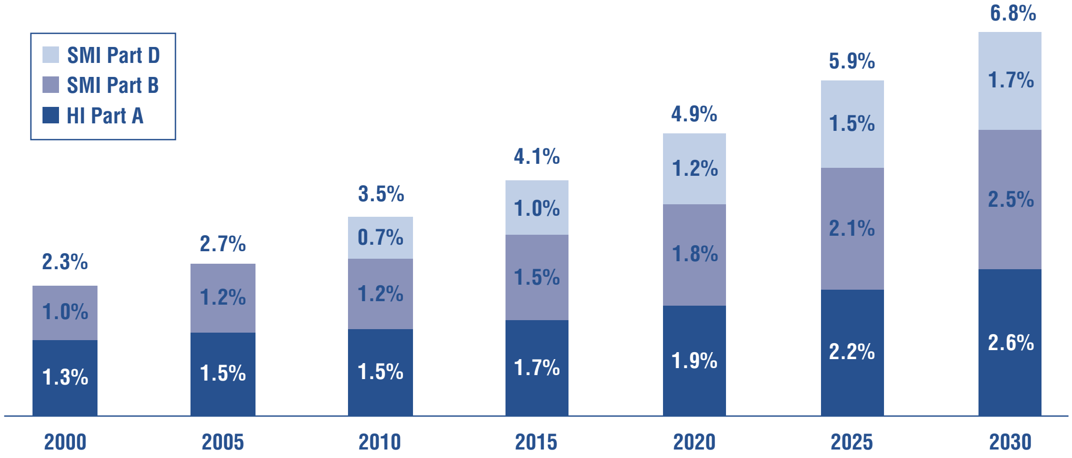
Figure 7.6
Historical and Projected Number of Medicare Beneficiaries and Number of Workers Per Beneficiary



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

Between 2000 and 2030, the number of Medicare beneficiaries is projected to increase from 40 million to 78 million. Because the Hospital Insurance Trust Fund is financed primarily through payroll taxes, its income is related to the number of people in the workforce. As the number of beneficiaries increases, the number of workers per beneficiary is projected to decrease from 4.0 in 2000 to 2.4 in 2030.

Figure 7.7
Projected Medicare Spending as a Percent of Gross Domestic Product (GDP), 2000–2030



Note: HI is Hospital Insurance. SMI is Supplementary Medical Insurance. Numbers may not sum to total due to rounding.
SOURCE: 2005 Annual Report of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds.

With the aging of the population and expected increases in overall health care costs, Medicare spending is projected to grow at a rate significantly higher than that of the overall economy, as measured by the gross domestic product (GDP). Between 2000 and 2030, Medicare's share of GDP is estimated to triple from 2.3 percent to 6.8 percent. The addition of the prescription drug benefit (Part D) in 2006 accounts for more than one-third of the increase.