

Is Medicare Solvent *and* Sustainable?

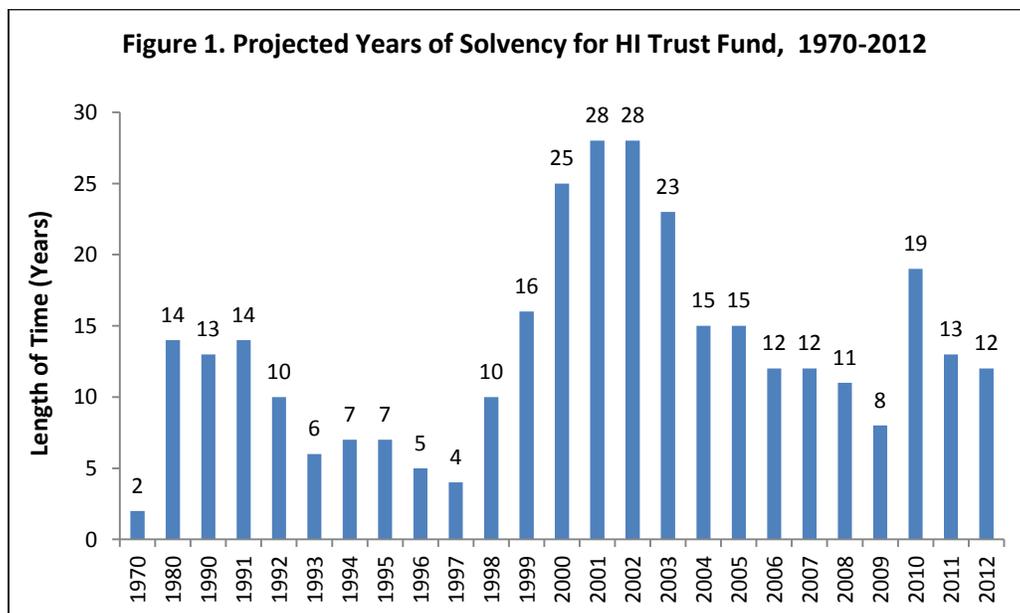
By Lee Goldberg and Sabiha Zainulbhai

Medicare is the nation's primary source of health care coverage for more than 48 million elderly and disabled Americans. In 2010, Medicare accounted for 15.1 percent of the federal budget and 3.6 percent of gross domestic product (GDP).¹ Its viability is vital for both the financial security of the people who depend on it now and for taxpayers who pay into Medicare and will rely on it in the future.

Solvency and Sustainability Defined

Solvency and sustainability are two useful but very different concepts for assessing the financial health of the Medicare program.² At a time when Medicare is at the forefront of national political debate, it is essential to think about both Medicare's solvency and sustainability without muddling the two terms.

Solvency is a measure of whether Medicare's two trust funds – the Hospital Insurance (HI) Trust Fund and the Supplementary Medical Insurance (SMI) Trust Fund – are able to pay the full cost of benefits prescribed by law on a timely basis. Sustainability is a much more subjective concept, one that cannot easily be addressed by the annual calculations of the Medicare trustees. Instead, it is a concept that is intended to reflect societal values and the political viability of the program as currently structured. Sustainability asks whether future Medicare spending is at a level that Americans are likely to be willing and able to pay for, based on projections of economic growth and spending.³



Source: Annual Reports of the Board of Trustees of the Federal Hospital Insurance and Federal Supplementary Medicare Insurance Trust Funds.

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Recent Data

Each year, the Medicare Trustees⁴ review the program's finances and project when the HI Trust Fund expenditures (benefits and administrative expenses) will exceed income (payroll taxes and other dedicated sources of revenue). The 2012 report found that Medicare's HI Trust Fund will remain solvent through 2024, after which annual revenue to the HI Trust Fund will be sufficient to cover 87 percent of benefits.⁵ The concern is not that Medicare will fully run out of funds in 2024, but that unless changes are made to outlays or revenues, or unless Congress appropriates additional funds, the HI Trust Fund will not have sufficient revenues and assets to pay its full costs. The 2012 report noted a financing gap that averages 13 percent a year from 2024 on.

In 2011, the HI Trust Fund received income of \$228.9 billion and paid out \$256.7 billion in benefits and administrative expenses, leaving a deficit of \$27.7 billion for the year. This is not a new turn of events: the HI Trust Fund has been running an annual deficit since 2008, drawing on accumulated reserves. At the end of 2011, the HI Trust Fund had \$244.2 billion in assets from earlier years when income exceeded expenditures. Because Medicare cannot borrow from the government when trust fund reserves are insufficient, the availability of assets in the HI Trust Fund over time is a critical factor for the program's solvency.⁶

As Figure 1 above indicates, estimates of HI solvency over time have ranged from two years to 28 years. Over the years, the solvency date has changed in response to changing economic conditions, demographics or the passage of legislation that has impacted Medicare outlays and revenues, such as the Balanced Budget Act in 1997 and the Patient Protection and Affordable Care Act in 2010. Regardless, benefits have always been paid fully and on time, even when insolvency was just two years away.

Projections of Medicare's solvency assess only the financial condition of Part A. Physician and outpatient services (Part B) and prescription drug coverage (Part D) are financed by the Supplementary Medical Insurance (SMI) Trust Fund. Unlike the HI Trust Fund, the SMI Trust Fund is always solvent. It is financed by a combination of beneficiary premiums and general revenue. Premiums are set annually to cover 25 percent of Part B and D expenses; the remainder is financed by the federal government's general revenues. Part B and D are solvent as long as current beneficiaries and current taxpayers provide financing.

As noted earlier, sustainability is a much more elusive concept than solvency. Thus, it is not surprising that there are no hard and fast measures that are used to define it. Putting aside the fact that many analysts believe it is not worthwhile trying to forecast what the economy or health care sector will look like 75 years into the future, the following are some commonly used measures in assessing Medicare's long-term sustainability.

- **Medicare as a Percent of GDP.** Medicare as a percent of GDP represents the cost of Medicare to society. Under current law, Medicare expenditures are projected to increase from 3.67 percent of GDP in 2011 to 6.73 percent of GDP by 2086.⁷
- **Actuarial Balance.**⁸ The actuarial balance is the difference between the projected annual income and projected annual cost to the HI Trust Fund, summarized as a percent of taxable payroll over the next 75 years. The actuarial balance in 2012 is negative, indicating a shortfall of 1.35 percent of taxable payroll over 75 years.⁹ This means that HI's long-range deficit could be avoided by increasing Medicare's HI payroll tax by 0.67 percent each for workers and employers (an increase from 1.45 percent to 2.12 percent).

- **Medicare Spending as a Percent of Total Federal Spending.** In 2010, federal spending on Medicare totaled 15.1 percent, and is projected to reach 17.4 percent by 2020.¹⁰ In comparison, in 2010, federal spending on Social Security totaled 20 percent and spending on Medicaid and the Children’s Health Insurance Program (CHIP) came out to 8 percent.¹¹

These three measures, while incredibly useful, cannot answer the question of whether Medicare is sustainable or not. Instead, they require a value judgment as to whether the program meets the needs of the elderly and disabled in that society and should be maintained in its current structure going forward.

Endnotes

¹ Kaiser Family Foundation, *Medicare Spending and Financing: A Primer*, February 2011, <http://www.kff.org/medicare/7731.cfm>.

² Stephen C. Goss, “The Future Financial Status of the Social Security Program”, *Social Security Bulletin* 70, No. 3 (2010): 111-125, <http://www.ssa.gov/policy/docs/ssb/v70n3/v70n3p111.pdf>. Also see Richard S. Foster and M. Kent Clemens, “Medicare Financial Status, Budget Impact and Sustainability – Which Concept is Which?”, *Health Care Financing Review* 27, No. 2 (Winter 2005-2006): 127-140, <http://www.cms.gov/Research-Statistics-Data-and-Systems/Research/HealthCareFinancingReview/downloads/05-06Winpg127.pdf>.

³ It is helpful when thinking about these concepts to view Medicare solvency as closely related to a Trust Fund perspective and Medicare sustainability as more closely related to a budgetary perspective in the context of societal values and political viability. For more discussion, see Foster and Clemens.

⁴ There are five ex-officio trustees: the Secretary of Health and Human Services, the Secretary of Labor, the Commissioner of the Social Security, the Administrator of the Centers for Medicare and Medicaid Services and the Secretary of the Treasury. There are also two “public” trustees, appointed by the President and confirmed by the Senate. The public trustees serve staggered terms of four years; one is a Democrat and one is a Republican.

⁵ Board of Trustees, *2012 Annual Report of the Board of Trustees, Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds*, Washington, DC: Centers for Medicare and Medicaid Services.

⁶ See *supra*, note 2.

⁷ See *supra*, note 5.

⁸ The actuarial balance (otherwise known as the HI deficit) could arguably be considered a measure of solvency or sustainability of Part A. On one hand, it assesses the shortfall as a percent of taxable payroll, indicating the amount by which Medicare payroll taxes would have to be increased to ensure solvency over the 75 year projection period. On the other hand, whether an HI deficit of 1.35 percent is viable for the future given other societal, political and economic factors is a value judgment.

⁹ See *supra*, note 5.

¹⁰ See *supra*, note 1.

¹¹ Kaiser Family Foundation, *Medicare Chartbook*, Fourth Edition, 2010, <http://facts.kff.org/chart.aspx?cb=58&sctn=169&ch=1793>.

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