Backgrounder

AMERICAN ACADEMY *of* ACTUARIES

Medicare

The Medicare program faces serious short-term and long-term financing problems. Leading the list of concerns is the impending insolvency of Medicare's Hospital Insurance (HI) trust fund. In terms of financing, Medicare has two parts. Earmarked payroll taxes finance Medicare's HI trust fund, which covers inpatient hospital services. Any unused payroll taxes accumulate in a trust fund. According to the 2008 Medicare Trustees Report, spending for these services will exceed payroll taxes this year. By 2019, the HI trust fund assets will be depleted and tax revenue will cover only 78 percent of benefit costs. Eliminating the gap between HI income and outgo over the program's 75 year projection period would require drastic changes — benefits would have to be cut in half or payroll taxes would have to more than double, or some combination of the two.

Medicare's other part, the Supplementary Medical Insurance (SMI) trust fund, covers physician and outpatient hospital services as well as the new Medicare prescription drug program. It's financed through beneficiary premiums and general income tax revenues. Unlike the HI trust fund, it's expected to remain solvent, only because its financing is increased annually to meet projected future costs.

But program solvency is not the only concern. Increasing health care spending will cause Medicare to consume ever-growing shares of the federal budget and the economy as a whole, threatening the program's long-term sustainability. In 2007, total Medicare spending was 3.2 percent of the nation's economy and about one out of every six federal revenue dollars was used for Medicare. It is projected that by 2050, Medicare's share of the economy will have nearly tripled. And if total federal revenues remain at their current share of the economy, Medicare could consume nearly one out of every two federal revenue dollars.

There is no perfect solution to Medicare's financial problems — in fact, Medicare's problems must be considered in the context of rising health care spending in the system as a whole. Each option has its drawbacks. Most likely, any viable solution will involve a combination of options and require taxpayers, Medicare beneficiaries, and health care providers to share the burden. Four criteria should be considered when evaluating potential reform proposals:

- Does it improve solvency, narrowing the gap between income and outgo?
- Does it reduce Medicare's demand on the budget and/or the economy?
- Does it permanently reduce health spending growth or is it only a one-time improvement?
- Does it reduce overall costs or simply shift costs from the government to another payer?

Additional Resources from the American Academy of Actuaries

- *Medicare's Financial Condition: Beyond Actuarial Balance* (March 2008)
  This issue brief discusses Medicare's financial condition in more detail, based on the findings from the 2008 Medicare Trustees Report.
- *Medicare Reform Options* (June 2007)
  This monograph presents various potential approaches for addressing Medicare's financial problems, along with their strengths and weaknesses.