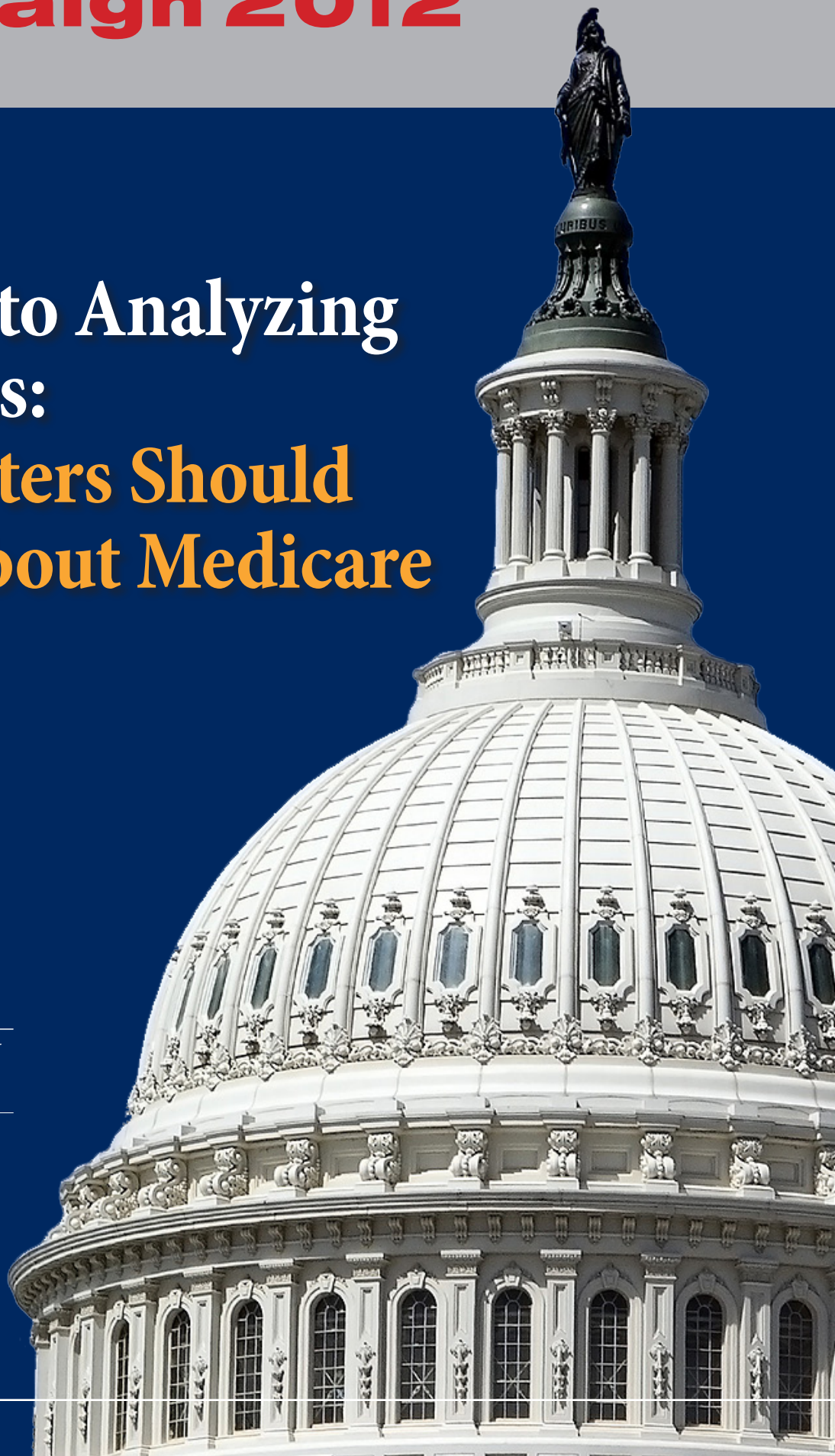
Campaign 2012

A Guide to Analyzing the Issues: What Voters Should Know About Medicare



American Academy of Actuaries

WHAT VOTERS SHOULD KNOW ABOUT MEDICARE

Medicare plays a critically important role in ensuring that older and certain younger disabled Americans have access to health care. But the program faces serious, long-term financing problems. As a result, the American Academy of Actuaries believes that policymakers need to take action to restore the long-term solvency and financial sustainability of the program. The sooner such corrective measures are enacted into law, the more flexible and gradual the approach can be.

Due to the importance of the Medicare program and the magnitude of the financial challenges, Medicare-related issues should figure prominently in the 2012 elections.

This guide is intended to help voters understand how Medicare is financed, the financial challenges facing the program, and some of the options available to improve Medicare's financial condition. Voters can use this information to encourage candidates to advance concrete proposals to improve the program's fiscal sustainability for current and future generations of Americans.

The American Academy of Actuaries is a 17,000-member professional association whose mission is to serve the public and the U.S. actuarial profession. The Academy assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

UNDERSTANDING MEDICARE

What Is Medicare?

Medicare is the federal program providing health insurance to virtually all Americans over the age of 65 and many younger long-term disabled individuals. Medicare beneficiaries can access benefits through either the traditional Medicare program or Medicare Advantage (MA) plans offered by private health insurers. Beneficiaries may purchase supplemental coverage (e.g., Medigap) to help fill in the gaps in Medicare coverage.

- The traditional Medicare program provides coverage for inpatient hospital services (Part A), and for physicians and outpatient care services (Part B).
- Medicare Advantage plans are offered by private insurers. The plans must cover at least all of the services that the traditional program covers; however, they may offer extra benefits either at no additional cost or for an additional premium.
- Medicare prescription drug benefits (Part D) are available through private insurers as a stand-alone plan to supplement traditional Medicare or as part of a Medicare Advantage plan.

How Is Medicare Funded?

Medicare is funded through two separate trust funds. The two trust funds support different parts of the Medicare program and are financed in different ways.

- The Hospital Insurance (HI) trust fund covers Part A and is financed largely through earmarked payroll taxes.
- The Supplementary Medical Insurance (SMI) trust fund covers Parts B and D. The SMI trust fund is financed through beneficiary premiums, which cover roughly one-fourth of the cost, and federal general tax revenues, which cover the remaining three fourths of the cost. Both beneficiary premiums and the amount of general revenues allocated to the trust fund are reset annually based on the projected cost for the coming year.
- Medicare Advantage plans are funded through both the HI and SMI trust funds.

How Is Medicare Doing Financially?

Medicare's current financing is inadequate to sustain the program for the long term, and over time it will place increasing financial demands on both beneficiaries and the federal budget. Medicare has three fundamental long-term financial problems:

1. **The payroll tax revenues supporting the HI trust fund are inadequate to fund the HI portion of Medicare benefits.** Spending is projected to exceed revenues in all future years, which means the trust fund will have to draw down assets each year to pay benefits. The HI trust fund is projected to run out of assets in 2024. At that point, payroll tax revenues will cover only 87 percent of program costs and even less thereafter. Ensuring that payroll taxes would be sufficient to pay benefits over the next 75 years would require an immediate 47 percent increase in payroll taxes, an immediate 26 percent decrease in benefits, or some combination of the two.
2. **Increases in SMI costs will place increasing financial pressures on both beneficiary**

household budgets and the federal budget. The SMI trust fund will remain solvent because its financing is reset each year to meet future costs. Projected increases in SMI expenditures, however, will require increases in beneficiary premiums and general revenue contributions. SMI costs are projected to grow from 2.0 percent of Gross Domestic Product (GDP) in 2011 to 4.0 percent of GDP in 2085.

3. **Increases in total Medicare spending threaten the program's sustainability.** Overall Medicare spending—including both HI and SMI—is projected to consume an ever-growing share of the nation's economy, threatening the program's long-term sustainability. Total Medicare costs are projected to grow from 3.7 percent of GDP in 2011 to 6.7 percent of GDP in 2085.

The sooner corrective measures are enacted, the more flexible and gradual the approach can be.

What's Causing the Problem?

Both the number of Americans enrolled in Medicare and the cost per enrollee are increasing. Medicare is challenged by the same rising health spending that is affecting the overall health care system. In the case of Medicare, the problem of rising health care costs is compounded by the aging of the population and the retirement of the baby boom generation.

Will the Recent Health Care Reform Law Fix the Problem?

Not fully. The Affordable Care Act (ACA) included a number of provisions designed to reduce Medicare spending, increase Medicare revenues, and develop new health care delivery systems and payment models to improve health care quality and cost efficiency. These have improved projections for Medicare's financial condition. But, while this was an important first step, it did not go far enough to put Medicare back on a sound financial footing. The financial challenges described above already reflect the anticipated improvements from the ACA.

OPTIONS FOR REFORMING MEDICARE

There is no one solution to Medicare's financial problems; any solution will require policymakers to make difficult choices and will involve a combination of options. Any solution likely will require taxpayers, Medicare beneficiaries, health care providers, and private insurers to share the burden. In simple terms, improving Medicare's financial condition will require:

- Increasing revenues,
- Reducing spending, or
- Some combination of both.

What Options Are Available for Reforming Medicare?

A number of specific options for improving Medicare's financial position have been included in recent debt and deficit reduction proposals but have not been enacted. Some of these are:

- Set spending targets to limit the growth in health spending.
- Expand the authority of the Independent Payment Advisory Board (IPAB).
- Transition to a premium support or voucher program.
- Reform the physician payment system.
- Reduce spending for prescription drugs.
- Revise the traditional Medicare benefit design and cost-sharing requirements.
- Raise the Medicare eligibility age.
- Increase Medicare Part B premiums for some or all beneficiaries.

More information on each of these options is provided below.

How Do You Decide Which Options Are Best?

Improving the sustainability of the health system requires slowing the growth in overall health spending, rather than just shifting the costs to from one payer to another. This means that unless system-wide spending is addressed, implementing options to control Medicare spending will have limited long-term effectiveness. And while controlling costs is vital to the sustainability of the program, it is not the only consideration. Slowing the growth in health spending, while maintaining or improving the quality of care, will require provider payment and health care delivery systems that encourage integrated and coordinated care.

To evaluate the various options for reforming Medicare, you should consider:

- How does the reform option affect the cost of the program?
- How does it affect beneficiaries' access to care?
- How does it affect the quality of care?
- Does it slow the growth in health spending, rather than just shifting costs from one payer to another?
- Does it give providers the incentives to provide, and their patients the incentives to obtain, the kind of integrated and coordinated care that could help control costs and improve quality?

Options to Reform Medicare

- **Set Spending Targets to Limit the Growth in Medicare Spending.** Specific spending targets could be established either for

Medicare in particular or for all federal health spending. If spending exceeded the targets, it could trigger specific automatic actions such as benefit reductions or revenue increases. As an alternative, the trigger could be structured to require the president or a commission to submit proposals that would have to be considered by Congress on an expedited basis.

- **Expand the Authority of the Independent Payment Advisory Board.** The ACA created the IPAB to make recommendations to reduce the growth in per capita Medicare spending if that spending exceeds a targeted growth rate. IPAB recommendations would be implemented automatically unless Congress passes legislation that produces comparable savings. The type of recommendations IPAB can make, however, are limited. The IPAB could be given authority to consider a wider range of recommendations, and the expansion of scope could be tied to more ambitious targets for reducing spending growth.
- **Transition to a Premium Support or Voucher Program.** These proposals would change Medicare from a defined benefit plan to a defined contribution plan, meaning government would limit the amount it contributes to Medicare coverage (or private plans). Beneficiaries would pay the difference between plan premiums and the government contribution.
- **Reform the Physician Payment System.** Physician payment rates are governed by the Sustainable Growth Rate (SGR) system, which aims to limit the growth in Medicare spending for physician services. Congress, however, typically overrides the physician fee cuts that the SGR formula would require (this override is known as the "doc fix"). Had Congress not continued to override the fee cuts, physicians would have seen a reduction in payments of almost 30 percent in 2012. Such a large decrease could have threatened beneficiary access to care. One approach to reforming Medicare physician payments would eliminate the SGR, temporarily freeze physician fees at their current level, and replace the SGR with a new physician payment system. Such an option would increase Medicare spending, however, unless it is offset by Medicare spending reductions.
- **Reduce Spending for Prescription Drugs.** Proposals to reduce spending for prescription drugs would require Medicare to negotiate drug prices under Part D, extend drug rebates to individuals who are eligible for both Medicare and Medicaid, or establish a government-run Part D option. Reducing prescription drug prices would lower Part D spending and beneficiary premiums.
- **Revise the Design of Traditional Medicare.** The benefit design for beneficiaries enrolling in traditional Medicare (as opposed to private Medicare Advantage plans) has several shortcomings. The lack of an out-of-pocket maximum leaves beneficiaries unprotected against catastrophic costs; most beneficiaries have supplemental coverage (e.g., Medigap) with low cost-sharing requirements that reduce incentives to seek cost-effective care; and the cost-sharing structure is not ideal for influencing consumer behavior. Updating the traditional

cost-sharing features could help better align beneficiary incentives to seek cost-effective care. Meeting this goal, however, may require changes to supplemental coverage as well. Proposals to update the traditional benefit design would change or combine the Part A and B cost-sharing requirements, add a maximum out-of-pocket limit, and/or eliminate first-dollar coverage in supplemental plans (or apply an additional charge to those plans).

- **Raise the Medicare Eligibility Age.** The current eligibility age for Medicare is 65; the normal retirement age for Social Security has been increased to age 67. There have been proposals to increase the Medicare eligibility age and perhaps even index it to increases in longevity. This would reduce Medicare costs, but the savings would be offset partially by increased federal spending in other areas such as Medicaid and the premium subsidies available through the new health insurance exchanges created by the ACA.
- **Increase Part B Premiums for Some or All Beneficiaries.** Most Medicare beneficiaries pay the standard Part B premium, currently set to cover25 percent of the average cost of Part B benefits. Higher-income beneficiaries, however, pay between 35 and 80 percent of the average cost. Some proposals would increase Part B premiums for those not already subject to higher premiums or raise them higher for those who are already paying relatively higher premiums. This would increase Medicare revenues by shifting costs to beneficiaries, but would not affect Medicare spending.

What You Can Do

Understand that There Is *No Silver Bullet*

There is no one, simple solution for shoring up Medicare. Ensuring that Medicare benefits are payable in the future almost certainly will require shared responsibility from Medicare beneficiaries, taxpayers, health care providers, and private insurers. When it comes to reform, sooner is better than later. Improving Medicare's long-term solvency and sustainability ultimately will require slowing the growth in health spending rather than just shifting costs from one payer to another. Slowing the growth in health spending, while maintaining or improving quality, will require provider payment and health care delivery systems that encourage integrated and coordinated care.

Learn as Much as You Can

The more you know about how Medicare works, its financial condition, and the options available for reform, the better equipped you will be to evaluate what candidates have to say about the program. You may want to start with the following Academy publications:

- Medicare's Financial Condition: Beyond Actuarial Balance (2012 update coming soon.)
- An Actuarial Perspective on Proposals to Improve Medicare's Financial Condition (May 2011)
- Revising Medicare's Fee-For-Service Benefit Structure (March 2012)

Speak Out

Encourage candidates for federal office to detail their approaches for putting Medicare on a sound financial footing. Ask Congress and the president to ensure the long-term future of the program.

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