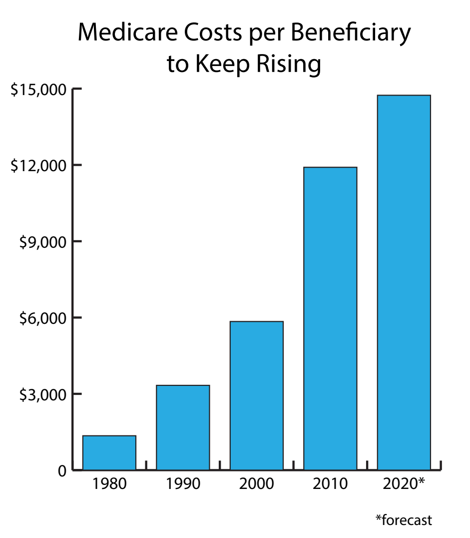
American Academy of Actuaries
Essential Elements
Making complex public policy issues clear
MAY 2020

Medicare's Long-Term Sustainability Challenge

Medicare plays a vital role in providing health care benefits to seniors and adults with permanent disabilities—more than 61.2 million Americans in 2019. But the federal government program faces long-term solvency issues. As noted in the 2020 Medicare Trustees Report, Medicare's Hospital insurance (HI) trust fund is projected to be depleted in 2026. In addition, increased spending in the program's Supplementary Medical Insurance (SMI) trust fund will increase pressure on beneficiary household budgets and the federal budget. Sustainability problems could be even worse than projected in the 2020 report, especially in the near term, due to the fact the report does not incorporate the effects of the COVID-19 pandemic on Medicare spending and revenues. Steps must be taken to ensure Medicare's long-term sustainability, although the impact is uncertain.



Source: 2020 Medicare Trustees Report

Medicare's trust funds

Medicare programs are operated through two funds: The HI trust fund mainly pays for inpatient hospital costs, and the SMI trust fund finances physician services, outpatient care, and the Part D prescription drug program.

The HI trust fund receives income primarily from payroll taxes and had assets of $200.4 billion at the beginning of 2019. HI expenditures in 2019 ($328.3 billion) exceeded HI revenues ($322.5 billion), with trust fund assets making up the difference and thereby declining to $194.6 billion at the end of 2019. A growing number of retirees coupled with increases in health care spending per beneficiary will cause HI spending to increase faster than its revenues, further depleting HI trust fund assets.

The SMI trust fund receives about three-quarters of its funding from general revenues and one-quarter from beneficiary premiums. SMI assets totaled $104.3 billion at the beginning of 2019 and grew to $108.8 billion at the end of 2019, as SMI revenues ($472.3 billion) outpaced expenditures ($467.9 billion).

MEDICARE AT A GLANCE IN 2019

Beneficiaries:
- 52.6 million seniors
- 8.7 million younger adults with permanent disabilities

Expenditures:
HI - $328.2 billion
SMI - $467.9 billion
Total - $796.1 billion

Income:
HI - $322.5 billion
SMI - $472.3 billion
Total - $794.8 billion

Total fund assets:
HI - $194.6 billion
SMI - $108.7 billion
Total - $303.3 billion

Projected HI Trust Fund depletion date:
2026

Source: 2020 Medicare Trustees Report

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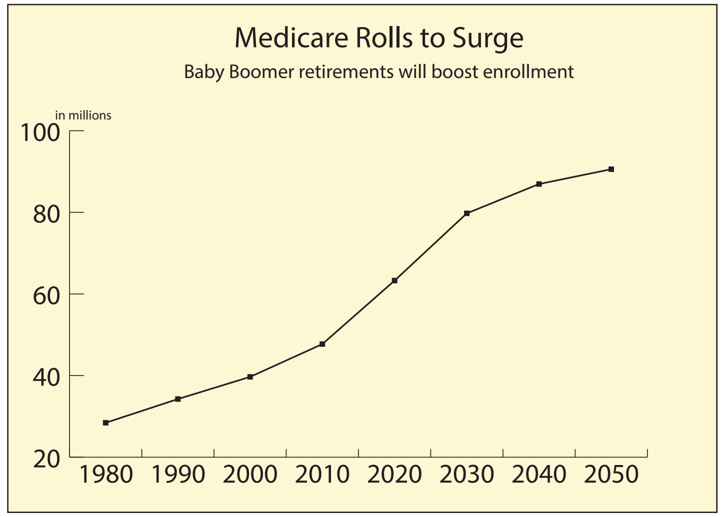

Source: 2020 Medicare Trustees Report

HI trust fund shortfall

The Medicare Trustees project that the HI trust fund's assets will run out in 2026 and, at that point, annual payroll taxes will cover only 90 percent of the program's costs.

Bringing the trust fund back into balance will require reductions in program spending, increased funding, or some combination of the two.

SMI spending to pressure government, household budgets

Medicare beneficiary premiums and general tax revenues fund the SMI trust fund, which is expected to remain solvent because the contribution amounts are reset annually. But increased beneficiary premiums (and cost-sharing) are projected to make up increasing shares of Social Security benefits, thus putting pressure on beneficiary household budgets. In addition, increasing general revenue contributions will place additional pressure on the federal budget.

Medicare costs grow faster than GDP

A key concern is whether Medicare costs, which are growing at a faster rate than the overall economy, are sustainable over time. In 2019, Medicare comprised 3.7 percent of gross domestic product (GDP), a measure of the entire U.S. economy. By 2094, Medicare will take up 6.5 percent of GDP, which essentially means a smaller share of the economy would be available for all other goods and services.

Conclusion

More needs to be done to put Medicare on a strong financial footing. By addressing Medicare's long-term solvency and sustainability challenges now, more gradual changes could be made sooner, giving beneficiaries and taxpayers more time to adjust. If Congress and the administration delay action, larger benefit cuts or tax increases for Medicare would be required.

Medicare's challenges are not solely financial. Medicare beneficiaries are a diverse group with diverse health care needs, and certain beneficiary populations—such as those with a disabilities or multiple chronic conditions—are particularly vulnerable to having high health care needs. Many beneficiaries have limited resources to rely upon should they be faced with high out-of-pocket health costs. Aside from the addition of the prescription drug program in 2006, Medicare's fee-for-service benefit package has remained mostly unchanged; some services aren't covered and beneficiary out-of-pocket costs are not capped. Therefore, any changes aiming to improve Medicare's financial condition should be considered in light of how the changes would impact the program's ability to meet the health care needs of beneficiaries and whether the changes would encourage beneficiaries to seek cost-effective care.

Additional Resources from the American Academy of Actuaries

Making Issues Count: Medicare (2020)
http://election2020.actuary.org/2020/01/09/medicare/

Medicare's Financial Condition: Beyond Actuarial Balance (2020)
https://www.actuary.org/sites/default/files/2020-04/MedFinCondIB.pdf

Medicare at 50: Is It Sustainable for 50 More Years? (2015)
http://www.actuary.org/files/Medicareat50_Sustainability_0715.pdf

Medicare at 50: Medicare Advantage Plans (2015)
http://www.actuary.org/files/Medicare@50.AdvantagePlans.pdf

Medicare at 50: Does It Meet the Needs of the Beneficiaries (2015)
http://www.actuary.org/files/Medicareat50_Benefits_0715.pdf

Medicare at 50: Who Are the Beneficiaries? (2015)
http://www.actuary.org/files/Medicareat50_Beneficiaries_0715.pdf