American Academy of Actuaries

Essential Elements

MAKING COMPLEX PUBLIC POLICY ISSUES CLEAR

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 65 million Americans in 2022. But the federal program faces short- and long-term solvency issues. As noted in the 2023 Medicare Trustees Report, Medicare's Hospital Insurance (HI) trust fund is projected to be depleted in 2031. Although this date is three years later than projected in the last year's report, it remains critical to address the HI shortfall sooner rather than later. 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. Steps must be taken to ensure Medicare's sustainability.

In the last three years, Medicare was significantly affected by the COVID-19 pandemic and recession of 2020, though the economy recovered more rapidly from the 2020 recession than had been previously expected. However, the trustees report noted that there is an unusually large degree of uncertainty in future projections, and therefore developments will be monitored and projections updated accordingly.

Medicare's trust funds

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

The HI trust fund receives income primarily from payroll taxes. The SMI trust fund receives about three-quarters of its funding from general revenues and one-quarter from beneficiary premiums. Chart 1 summarizes the trust fund operations for 2022.

HI trust fund shortfall

The Medicare trustees project that the HI trust fund's assets will run out in 2031 and, at that point, annual payroll taxes will cover only 89% of the program's costs, with the share declining to 81% in 2047 and then increasing to 96% in

Medicare Trust Fund Operations in 2022

Beneficiaries:
- 57.1 million retired workers
- 7.9 million disabled workers and dependents

Expenditures:
- HI - $342.7 billion
- SMI - $562.4 billion
- Total - $905.1 billion

Income:
- HI - $396.6 billion
- SMI - $591.9 billion
- Total - $988.6 billion

Total fund assets:
- HI - $196.6 billion
- SMI - $212.5 billion
- Total - $409.1billion

Source: 2023 Medicare Trustees Report

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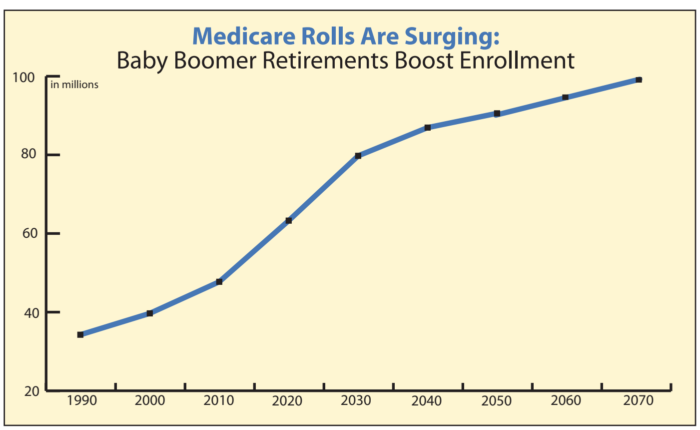
2097. Bringing the trust fund back into balance will require an immediate 21% increase in payroll taxes, a 13% reduction in expenditures, or some combination of payroll tax increases and expense reductions.

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 take 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.

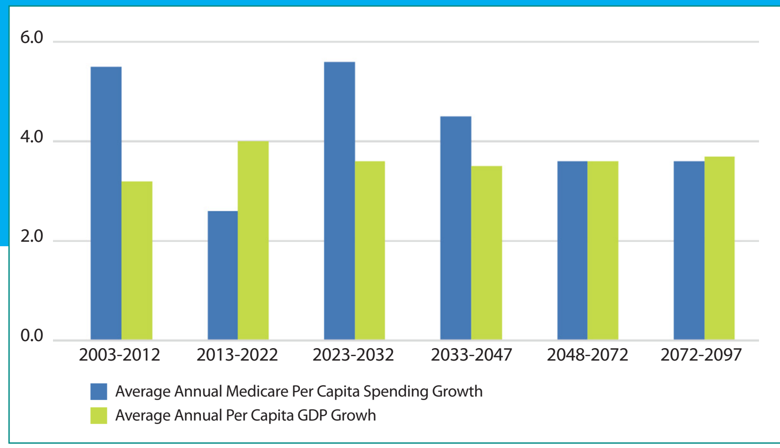
Medicare costs grow faster than GDP

A key concern is whether Medicare costs, which are growing at a faster rate than the overall economy, are sustainable over time. Costs are rising not only due to increasing numbers of beneficiaries, but also due to higher spending per beneficiary. In 2022, Medicare comprised 3.7% of gross domestic product (GDP), a measure of the entire U.S. economy. By 2097, Medicare will take up 8.3% of GDP, which means a smaller share of the economy would be available for all other goods and services.



Source: 2023 Medicare Trustees Report

After Recent Slowdown, Per Beneficiary Medicare Spending Again Expected to Exceed Per Capita GDP Growth



Source: American Academy of Actuaries calculations based on the 2023 Medicare Trustees Report

Conclusion

More needs to be done to put Medicare on a strong financial footing. By addressing Medicare's 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 disability 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.

Resources

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Medicare's Financial Condition: Beyond Actuarial Balance

American Academy of Actuaries - Medicare