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The 2010 Medicare Trustees Report August 9, 2010

Last week, the Social Security and Medicare Trustees released their 2010 reports on the financial status of both programs. Last Friday, we offered an analysis of the [Trustees' Social Security projections](#). We also recently looked at CBO's interpretation of the [effect of health reform on the long-term](#). This paper will focus on the Trustees' projections for Medicare.

Medicare Projections

Medicare costs are scheduled to continue growing as a share of the economy, and Medicare Part A (Hospital Insurance), which is already running cash flow deficits, is likely to permanently exceed its dedicated revenue source by the end of the decade. This remains the case even under the most optimistic (and as the Trustees point out, unrealistic) assumption regarding health care reform and even assuming that much of the savings from health reform—which were used to pay for the new costs of expanded coverage—are applied to the Medicare system.

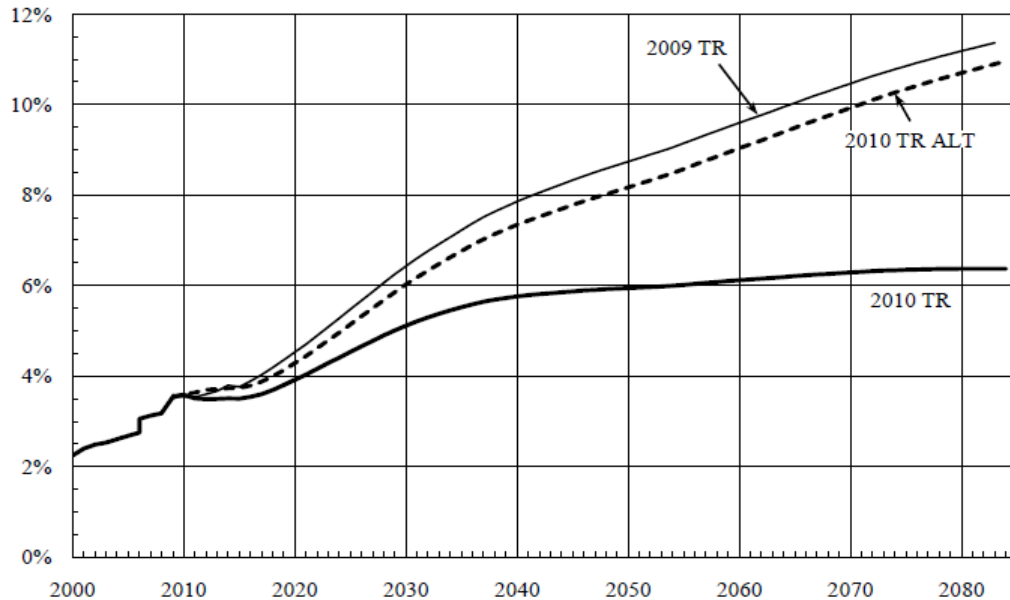
Under current law, assuming the Medicare cuts from the health reform legislation are *fully* implemented (unlikely) and no further doc fixes are implemented (highly, highly unlikely), total Medicare costs will grow from 3.6 percent of GDP today, to about 5 percent by 2030, 6 percent by 2050, and 6.4 percent by 2080. This is a very substantial improvement from last year's projections, when costs were projected to grow to nearly 6.5 percent of GDP by 2030, 7 percent by 2050, and more than 11 percent by 2080. The HI trust fund is also projected to remain solvent through 2029 on an actuarial basis, as compared to 2017 last year, though on a cash flow basis, it will remain negative for at least a few more years.

As CRFB has [explained before](#), the continued provider payment cuts scheduled in law will not be sustainable over the very long-run. As the Medicare chief actuary explains, the Trustees' current law projections "do not represent the 'best estimate' of actual future Medicare expenditures."

Under the current law projections, Medicare provider payments would drop below Medicaid payments by the end of the decade. And they would fall from nearly 80 percent of private insurance prices today to about 50 percent by 2050 and 35 percent by the end of the 75-year window.

Under the Medicare Actuaries' Alternative Scenario, Medicare's costs will reach 6 percent of GDP by 2030, pass 8 percent by 2050, and exceed 10 percent after 2070. This is an improvement from last year's projections, but not nearly by as much as under the Trustees' current law projections.

Fig. 1: Medicare Expenditures as a Percent of GDP under the Trustees Report (TR) and Alternative Scenario (ALT)



Source: Medicare Trustees and Medicare Chief Actuary.

Assumptions on Health Care

Long-run budgetary projections in general and health care projections, specifically, are inherently uncertain. This uncertainty is magnified many times over in light of the recently-passed health reform legislation.

One important question is how to disentangle Medicare cuts in the legislation from the slowing in health care cost growth which is already projected in the baseline. (See more on this [here](#).) Essentially, the Trustees assume no interaction under their current law scenario and simply layer the provider payment update cuts ("productivity adjustments") on top of existing cost growth assumptions. CBO does the same through 2030, but assumes overall health care costs will grow at pre-reform rates beyond that period.

Since both CBO and the Trustees are also skeptical that these provider payment update cuts can be sustained over the long-run, they also produce Alternative Scenarios (technically, the Trustees ask the Medicare Actuary to produce this scenario) which make several political assumptions. CBO assumed that reductions in Medicare growth rates would not continue after 2020 (though the old growth rates would be applied to a

lower level of Medicare spending). The Trustees, meanwhile, assume that the payment update cuts will phase out between 2020 and 2034, after which per capita costs will grow at pre-reform levels. Both alternative scenarios assume that policymakers will override the 30 percent in physician payment cuts scheduled over the next few years under the “Sustainable Growth Rate.”

Fig. 2: Comparison of Assumptions under Trustees' and CBO's Current Law and Alternative Scenarios

	Current Law		Alternative Scenario	
	Trustees	CBO	Trustees	CBO
Physician Payments	Physician payments will be cut by about 30% over three years in line with the current SGR formula.		Physician payments increase in line with the Medicare Economic Index (MEI).	
Cuts to Provider Payment Updates from Health Reform	Cuts will keep cost growth about 1.1% per year lower, indefinitely.	Cuts will slow Medicare cost growth through 2030.	Cuts will keep cost growth about 1.1% per year lower through 2020, then phase out by 2034.	Cuts will slow Medicare cost growth through 2020.
Medicare Costs in 2040 (percent of GDP)	5.8%	6.4%	7.3%	7.3%
Medicare Costs in 2080 (percent of GDP)	6.4%	N/A*	10.7%	N/A*

*CBO does not separate Medicare costs from other federal health costs beyond 2035.

Source: Medicare Trustees, Medicare Chief Actuary, and author's extrapolations.

Hospital Insurance (Medicare Part A)

Medicare Part A is operated out of a trust fund with a dedicated revenue source—in a manner similar to the Social Security system. Prior to the enactment of health reform, the program was funded primarily from a 2.9 percent payroll tax (with no taxable maximum), with some additional funds coming from the taxation of Social Security benefits and other sources.

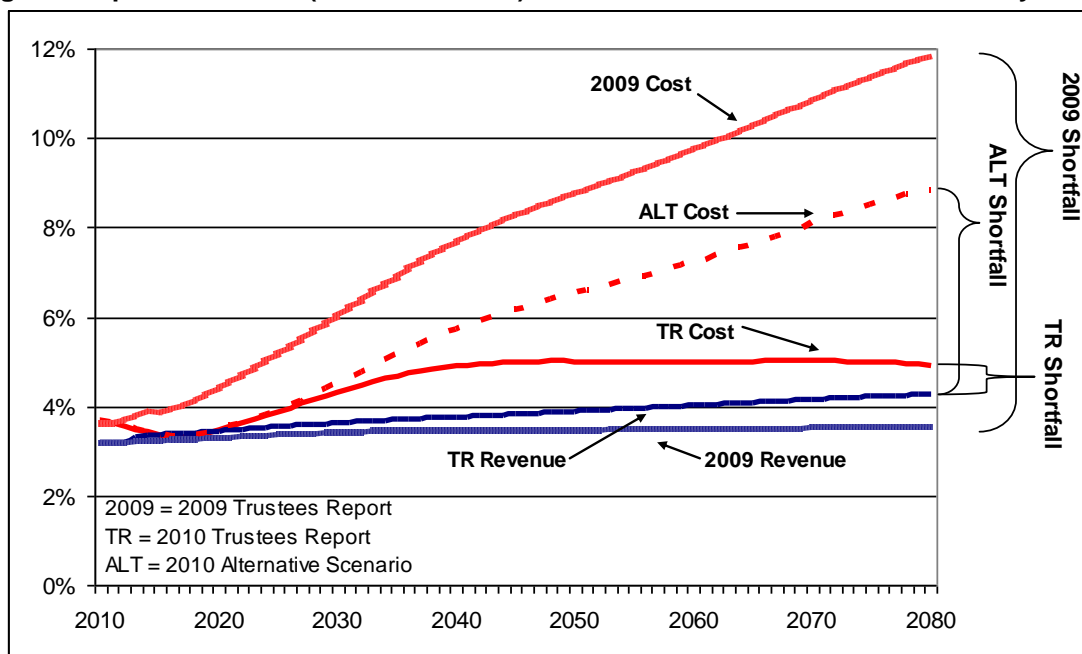
Last year's Trustees report showed expenditures to already have exceeded revenues, with the trust fund scheduled to run out of money by 2017. Those projections put the program's 75-year actuarial shortfall at 3.88 percent of payroll. Due to a combination of 0.9 percent payroll tax increase on income above \$200,000 (\$250,000 for couples) and significant cuts in Medicare spending—both provisions from the health reform package—this year's Trustees report projects a 75-year shortfall of only 0.66 percent of payroll. Under the Actuary's Alternative Scenario, the shortfall increases to 1.91 percent of payroll.

Fig. 3: Hospital Insurance (Medicare Part A) Actuarial Balance as a Percent of Payroll

	Trustees Report	Alternative Scenario
2009 Balance	-3.88%	-3.88%
<i>Higher Revenue:</i>	<i>0.37%</i>	<i>0.37%</i>
<i>Lower Costs:</i>	<i>2.85%</i>	<i>1.60%</i>
2010 Balance	-0.66%	-1.91%

It is important to note, though, that much of the tax increases and spending cuts in the health reform legislation was used to finance a new regime of health insurance subsidies and an expansion of Medicaid. Though from a legal standpoint this money can also be used to strengthen Medicare’s solvency, from an economic standpoint the money cannot be counted twice. As CBO has explained, this money “cannot be set aside to pay for future Medicare spending and, at the same time, pay for current spending on other parts of the legislation or on other programs... To describe the full amount of HI trust fund savings as both improving the government’s ability to pay future Medicare benefits and financing new spending outside of Medicare would essentially double-count a large share of those savings.”

Fig. 4: Hospital Insurance (Medicare Part A) Revenue and Costs as a Percent of Payroll



Source: Medicare Trustees, Medicare Chief Actuary, and authors’ extrapolations.

Supplemental Medical Insurance (Medicare Part B and Part D)

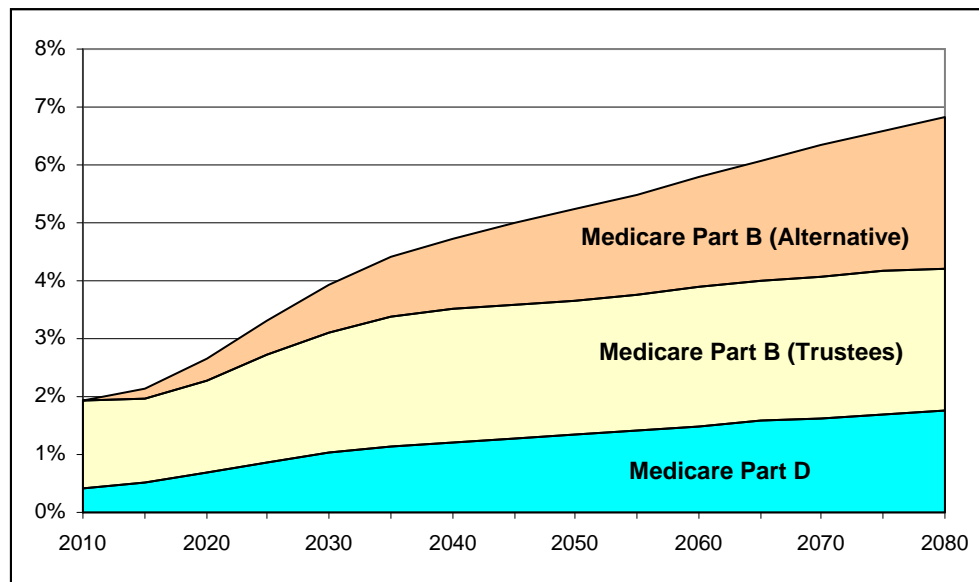
Whereas Medicare Part A is financed primarily by a payroll tax, Parts B and D are financed mainly through a combination of premiums and general revenue (with the latter covering about three quarters of the costs in a typical year).

Under current law, the cost of the two programs will grow gradually from 1.9 percent of GDP today to 3.1 percent of GDP in 2030 and 4.2 percent by 2080. This growth is far slower than last year’s pre-reform projections, when SMI was projected to reach 3.7 percent of GDP in 2030 and 6.2 percent in 2080.

However, as with the HI projections, these are unlikely to be sustainable. For one, the Trustees project Medicare Part B's costs to *fall* as a percent of GDP over the next few years, due to scheduled cuts in physician payments totaling about 30 percent. And after growing by about 50 percent of GDP between now and 2035, Part B's costs are projected to nearly stabilize as a share of the economy due to the provider payment update cuts in the health care bill.

Under the Actuary's Alternative Scenario, where the sharp physician payment cuts do not occur and the provider payment update reductions phase out by 2024, SMI costs will grow far more quickly – to nearly 7 percent of GDP by 2080.

Fig. 5: Supplemental Medical Insurance (Medicare Parts B and D) as a Percent of GDP



Conclusion

As a result of the newly passed health reform legislation, the Medicare Trustees project substantial improvements in the financial paths of all parts of Medicare. Unfortunately, as the Medicare Actuary points out, the Medicare cuts in the legislation will almost certainly prove unsustainable over the long-run. In addition, many of the savings in the legislation will be used to finance new health care costs rather than improve the overall fiscal picture. And the Trustees further underestimate likely costs, since they assume policymakers will allow 30 percent in cuts to physician payments – cuts which they have continuously averted over the last decade.

In order to prevent federal health costs from exploding, policymakers must work to maintain the cuts from health reform as long as possible, and must continue to pursue reforms aimed at slowing public and private health care cost growth. As we've argued before, [health reform is a continuous process and will require continued vigilance](#).