THE HENRY J. KAISER FAMILY FOUNDATION

FACT SHEET

MEDICARE

MEDICARE SPENDING AND FINANCING

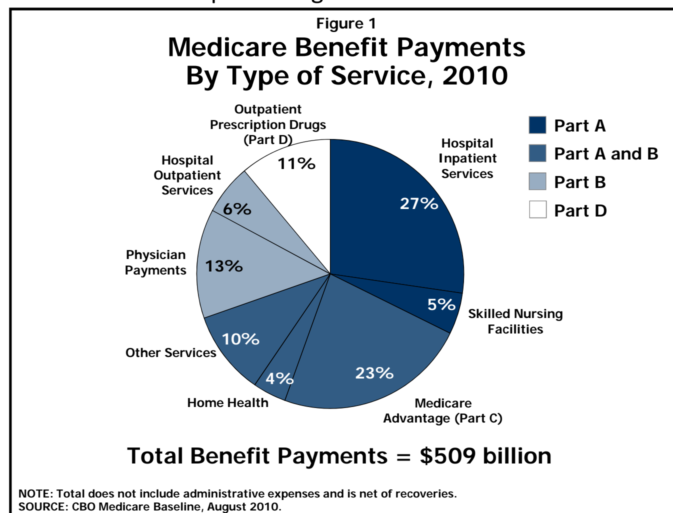
AUGUST 2010

OVERVIEW OF MEDICARE SPENDING

Medicare, the federal health insurance program for 47 million elderly and disabled Americans, helps to pay for hospital and physician visits, prescription drugs, and other acute and post-acute services. In 2010, spending on Medicare accounts for 12% of the federal budget.

Medicare benefit payments are expected to total $509 billion in 2010 (Figure 1):

- Part A – Hospital Insurance (HI) = 36%
- Part B – Supplementary Medical Insurance (SMI) = 29%
- Part C – Medicare Advantage (private health plans) = 23%
- Part D – Prescription drug benefit = 11%

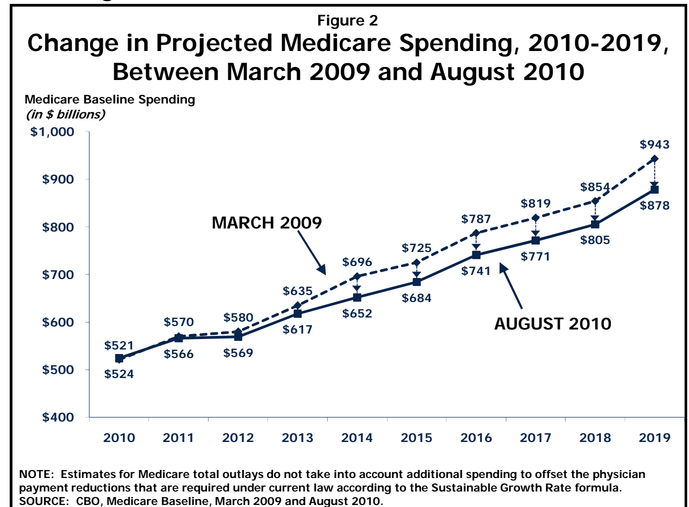


Medicare plays a major role in the health care system because it accounts for 23% of total national health care spending. Medicare accounts for nearly one-third (30%) of total national spending on hospital care and 20% of total spending on physician services.

THE 2010 HEALTH REFORM LAW AND MEDICARE SPENDING

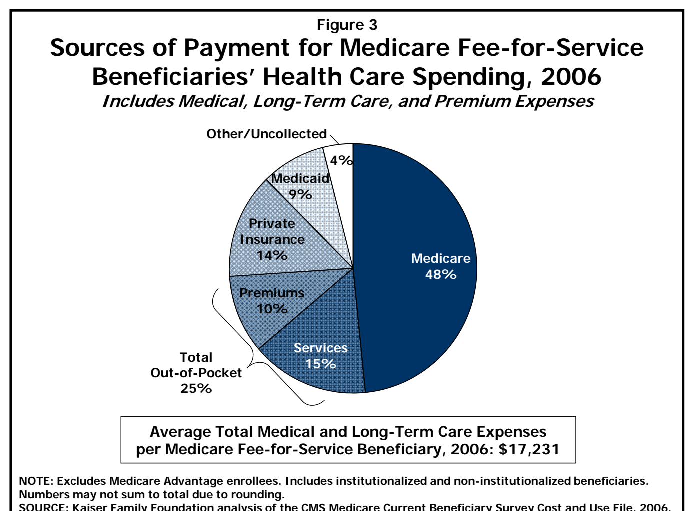
Medicare spending is projected to increase from $519 billion in 2010 to $929 billion in 2020, taking into account changes to Medicare incorporated in the Affordable Care Act of 2010 (CBO, August 2010). The law is projected to reduce annual growth in Medicare spending over the next decade and beyond, by reducing the growth in Medicare payments to health care providers and Medicare Advantage plans, establishing several new policies and programs designed to reduce costs and improve quality of patient care, and establishing a new Independent Payment Advisory Board to recommend Medicare spending reductions if projected spending exceeds target growth rates. The law also increases the Medicare Part A payroll tax rate for higher-income people, and increases Part B and Part D premiums for higher-income beneficiaries.

Average annual growth in Medicare spending is projected to be 5.8% between 2012 and 2020, according to CBO. Total Medicare spending for the ten-year period between 2010 and 2019 is projected to be $322 billion lower than had been estimated for the same period, partly as a result of the Medicare provisions included in the health reform law (Figure 2). The average annual growth rate in Medicare spending between 2010 and 2019 is estimated to be 5.9%, nearly one percentage point lower than projections for this period prior to the passage of the health reform law. These projections do not take into account additional spending that would be needed to offset the physician payment reductions that are required under current law according to the Sustainable Growth Rate formula.



MEDICARE'S SHARE OF TOTAL MEDICAL SPENDING

In 2006, Medicare paid just under half (48%, or $8,344) of the $17,231 in average total medical and long-term care expenses per beneficiary in fee-for-service (FFS) Medicare (Figure 3). Beneficiaries paid 25% of this total out-of-pocket, including premiums. Medicare spending per beneficiary is highly skewed, with the top 10% of beneficiaries in FFS



The Henry J. Kaiser Family Foundation Headquarters: 2400 Sand Hill Road, Menlo Park, CA 94025 (650) 854-9400 Fax: (650) 854-4800
Washington Offices and Barbara Jordan Conference Center: 1330 G Street, NW, Washington, DC 20005 (202) 347-5270 Fax: (202) 347-5274 **Website:** www.kff.org
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Medicare accounting for 58% of total Medicare spending in 2006 – on a per capita basis, nearly six times greater than the average across all FFS beneficiaries ($48,210 versus $8,344).

HOW IS MEDICARE FINANCED?

Medicare is funded primarily from three sources: general revenues (43%), payroll tax contributions (37%), and beneficiary premiums (13%) (Figure 4). Medicare Parts A, B, and D are financed separately, as follows:

- Part A is financed largely through a 2.9% tax on earnings paid by employers and employees (1.45% each) (accounting for 85% of Part A revenue). The health reform law increases the Medicare payroll tax for higher-income taxpayers (more than $200,000/individual and $250,000/couple) by 0.9 percentage points (from 1.45% to 2.35%), beginning in 2013.
- Part B is financed through general revenues (74%) and beneficiary premiums (25%). Beneficiaries who have higher annual incomes (over $85,000/individual, $170,000/couple) pay a higher, income-related monthly Part B premium reflecting a larger share of total spending, ranging from 35% to 80%; beginning in 2011, the health reform law freezes the income thresholds at 2010 levels through 2019.
- Part D is financed through general revenues (82%), beneficiary premiums (10%), and state payments for dual eligibles (7%). The health reform law establishes a new income-related Part D premium similar to the Part B premium, beginning in 2011, where higher-income beneficiaries will pay a larger share of the cost of standard drug coverage and receive a smaller premium subsidy.

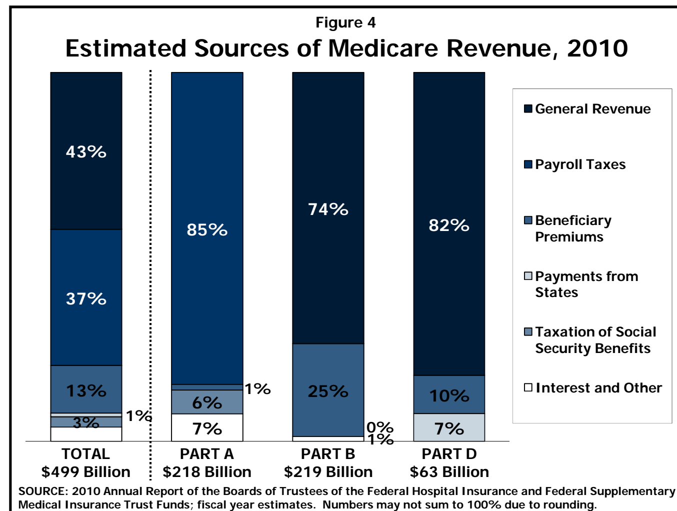

Figure 4
Estimated Sources of Medicare Revenue, 2010

SOURCE: 2010 Annual Report of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds; fiscal year estimates. Numbers may not sum to 100% due to rounding.

MEASURING MEDICARE'S FINANCIAL CONDITION

Medicare's financial condition is measured in a number of ways, including assessing the status of the Part A Trust Fund and comparing total Medicare spending to the gross domestic product, the federal budget, and national health spending. Over time, Medicare spending is projected to represent a growing share of the economy, federal spending, and the nation's total health spending.

According to the 2010 Medicare Trustees report, the Part A trust fund will be depleted in 2029, at which point Medicare will not have sufficient funds to pay full benefits, unless Congress acts as it has in the past to make changes to improve the fiscal outlook of Part A (Figure 5). Medicare is projected to grow from 3.6% of GDP in 2010 to 3.9% in 2020 and 5.1% in 2030. These estimates are lower than previous years' projections due to spending reductions enacted in the 2010 health reform law. SMI trust fund assets are projected to be adequate because beneficiary premiums and general revenue contributions are set to match expected outlays for Part B and Part D each year.

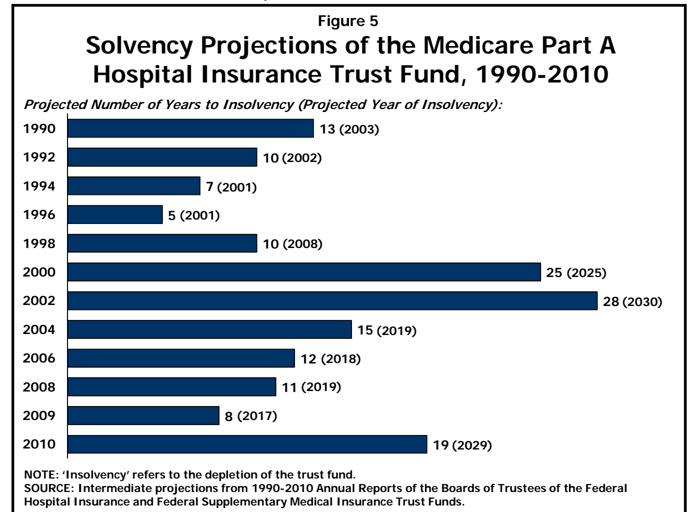

Figure 5
Solvency Projections of the Medicare Part A Hospital Insurance Trust Fund, 1990-2010

NOTE: 'Insolvency' refers to the depletion of the trust fund.
SOURCE: Intermediate projections from 1990-2010 Annual Reports of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds.

FUTURE CHALLENGES

Sustained increases in health care costs are placing upward pressure on Medicare spending, as for other payers. Annual growth in Medicare spending is influenced by the same factors that affect health spending in general: increasing prices of health care services, increasing volume and use of services, and new technologies. Moving forward, system-wide efforts to curtail overall health care costs, such as those enacted as part of the 2010 health reform law, could help to improve Medicare's financial outlook. Over the long term, an aging population, a decline in the number of workers per beneficiary, and increasing life expectancy will present fiscal challenges for Medicare. From 2010 to 2030, the number of beneficiaries is projected to rise from 47 million to 80 million, while the ratio of workers per beneficiary is expected to decline from 3.5 to 2.3.

Medicare provides essential coverage for its beneficiaries and enjoys broad public support. Yet many people on Medicare face significant out-of-pocket costs for both premiums and non-premium expenses to meet their medical and long-term care needs. With health costs rising faster than beneficiaries' incomes, median out-of-pocket health spending as a share of income increased from 11.9% in 1997 to 16.2% in 2006. How to ensure Medicare's financial stability over the long term without shifting excessive costs onto beneficiaries, while meeting the health care needs of an aging population, is a pressing challenge for the nation.

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