

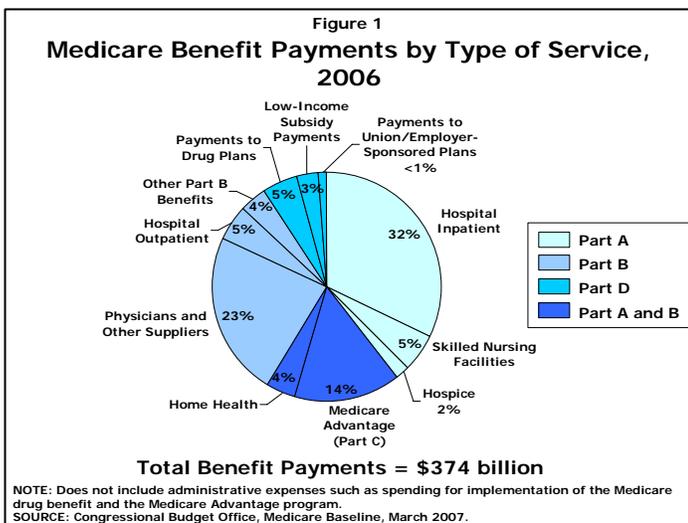
MEDICARE

MEDICARE SPENDING AND FINANCING

June 2007

Medicare is a federal health insurance program for 44 million elderly and disabled Americans, providing coverage for acute and post-acute care. Medicare consists of four parts (Figure 1):

- Part A for Hospital Insurance (HI), accounting for 39% of benefit payments;
- Part B for Supplementary Medical Insurance (SMI), accounting for 32% of benefit payments;
- Part C for Medicare Advantage (private health care plans), accounting for 15% of benefit payments; and
- Part D for prescription drug coverage, accounting for 9% of benefit payments.

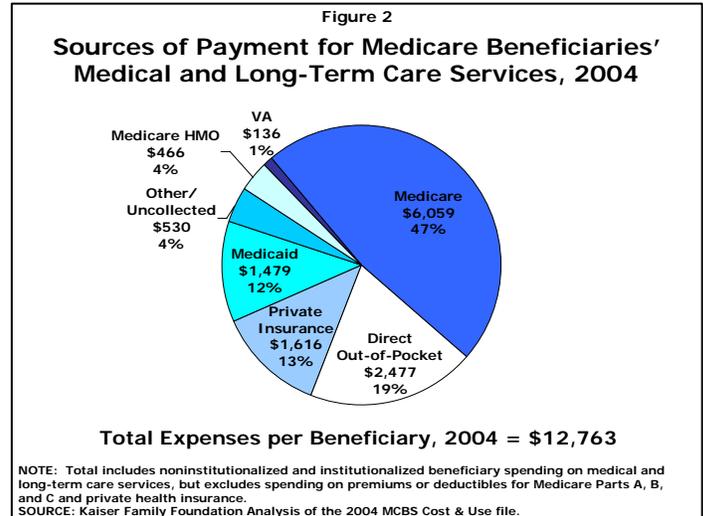


OVERVIEW OF MEDICARE SPENDING

Medicare spending is a large component of the federal budget and national health spending. In 2006:

- Medicare benefit payments totaled \$374 billion;
- Medicare spending accounted for 12% of the federal budget (OMB, 2007); and
- Spending on Medicare benefits was 20% of the nation's total health care spending (CMS OACT, 2007).

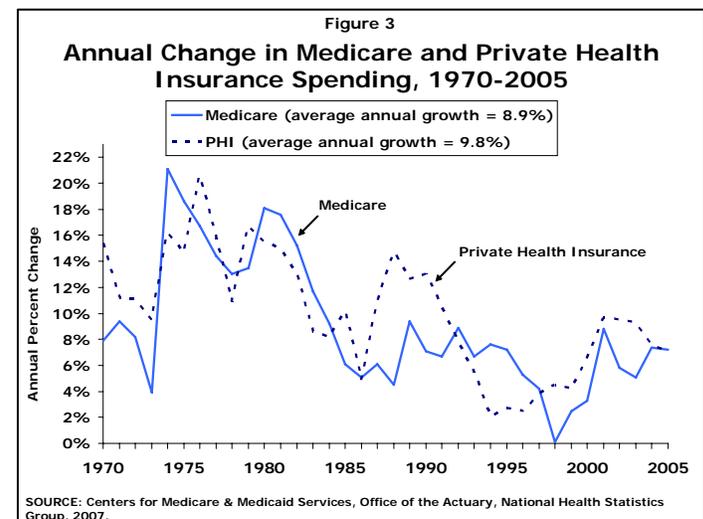
Medicare helps beneficiaries pay for hospital, physician, and other medical care. In 2004, Medicare paid just under half of the \$12,763 in total medical expenses per beneficiary, while beneficiaries paid 19% out of pocket (Figure 2). Out-of-pocket medical spending consisted primarily of long-term facility care (30%), provider visits and medical supplies (28%), and prescription drugs (22%). These estimates exclude out-of-pocket spending on premiums for Medicare (the Part B premium is \$93.50 per month in 2007) and for private health insurance, including Part C and Part D plans, which could add significantly to beneficiaries' out-of-pocket spending burden.



Spending per beneficiary is highly skewed, with 10% of beneficiaries accounting for two-thirds of total Medicare spending. Medicare spending for beneficiaries in their last year of life is on average four times greater (\$22,107) than for all other beneficiaries (\$5,694).

Medicare beneficiaries tend to be sicker than the non-elderly, and therefore use more medical services and incur higher spending on a per capita basis than people with private health insurance. Since Medicare's inception, however, growth in annual spending per beneficiary has been approximately one percentage point lower than private health insurance spending (Figure 3).

Looking forward, program spending is projected to grow annually by 7.8% between 2007 and 2016, after a one-time increase in overall Medicare spending of 22.1% between 2005 and 2006 due to implementation of Part D (CMS OACT, 2007).



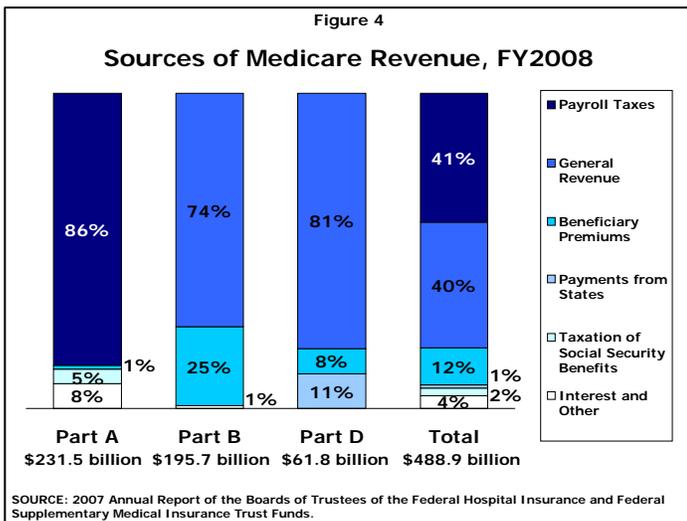
THE IMPACT OF PART D ON MEDICARE SPENDING

The implementation of the Part D drug benefit in 2006 shifted drug payments from other payers to Medicare and contributed to an increase in federal spending. Medicare's share of total national spending on prescription drugs increased from 2% in 2005 to 22% in 2006. Between 2007 and 2016, the Administration estimates that benefit payments for the Medicare drug benefit will total \$982 billion. Cost projections for Part D over the next decade are lower than originally estimated, however, due to lower-than-projected enrollment in Part D and the low-income subsidy program, competitive bidding between plans, and slower growth in prescription drug costs since 2004 than in prior years.

HOW IS MEDICARE FINANCED?

Funding for Medicare comes primarily from payroll tax revenues, general revenues, and premiums paid by beneficiaries (Figure 4).

- Part A is financed largely through a dedicated tax of 2.9% of earnings paid by employers and their employees (1.45% each).
- Part B is financed through a combination of general revenue and premiums paid by beneficiaries.
- Part C is not separately financed; it is a vehicle for providing Part A, Part B, and (usually) Part D benefits.
- Part D is financed from beneficiary premiums, general revenues, and state payments for dual eligibles.



MEASURING MEDICARE'S FINANCIAL CONDITION

Medicare's financial condition is measured in a number of ways, including spending as a percent of the gross domestic product, the federal budget, and national health expenditures (Figure 5). Over time, Medicare spending is projected to represent a growing share of the economy, federal spending, and the nation's total health spending.

Medicare's financial health is also measured in the status of Medicare's HI and SMI trust funds, assessed each year by the Medicare Board of Trustees. According to the 2007 Trustees' report, spending of HI trust fund assets is projected to exceed income beginning in 2011; the HI trust fund reserves are projected to be exhausted in 2019. SMI trust fund assets are projected to be adequate because each year, beneficiary premiums and

general revenue contributions are set to match expected outlays for Part B and Part D.

The Medicare Modernization Act of 2003 (MMA) established a new way of assessing Medicare's financial status, by looking at general revenues as a share of total Medicare spending. The Board of Trustees reports annually whether general revenues are projected to finance 45% or more of Medicare spending in any of the next 7 years. In 2007, the Medicare Trustees projected that general revenues will exceed 45% of total Medicare spending in 2013, within the seven-year timeframe. This followed a similar determination made in the 2006 report, prompting the Trustees to issue a "Medicare funding warning." As a result, the President is required to submit to Congress in 2008 proposed legislation to respond to the warning, with Congressional consideration of this legislation to occur on an expedited basis.

Figure 5
Alternative Measures of Medicare Spending, 2007-2016

	2007	2008	2010	2013	2016
Spending as % of Gross Domestic Product*	3.2%	3.3%	3.4%	3.7%	4.5%
Spending as % of National Health Expenditures**	19.7%	19.8%	19.9%	20.3%	20.9%
Years to HI Trust Fund Depletion* (2007 projections)	12 years	11 years	7 years	5 years	3 years
General Revenue as a Share of Total Medicare Spending*	39.7%	41.4%	42.9%	45.2%	48.3%

SOURCE: *2007 Annual Report of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds. **Centers for Medicare and Medicaid Services, Office of the Actuary, National Health Statistics Group, February 2007.

FUTURE CHALLENGES

Annual increases in health care costs will continue to place upward pressure on Medicare spending, as for other payers. Annual growth in Medicare spending is largely influenced by the same factors that affect health spending in general: increasing prices of health care services, increasing volume and utilization of services, and expensive new technologies. In the past, provider payment reforms, such as the hospital prospective payment system, have helped to limit the growth in Medicare spending. Moving forward, system-wide efforts to curtail overall health care costs would help to improve Medicare's financial outlook.

Over the longer term, the aging of the baby-boom generation, a decline in the number of workers per beneficiary, and increasing life expectancy will present fiscal challenges for Medicare. From 2000 to 2030, the number of people on Medicare is projected to rise from 39 million to 79 million, while the number of workers to support beneficiaries is projected to decline from 4.0 workers per beneficiary to 2.4 workers per beneficiary.

Medicare provides essential coverage for its beneficiaries and enjoys broad public support. How to ensure the program's financial stability over the long term, while meeting the health care needs of an aging population, is a pressing challenge for the nation.