American Academy of Actuaries
Essential Elements
Making complex public policy issues clear
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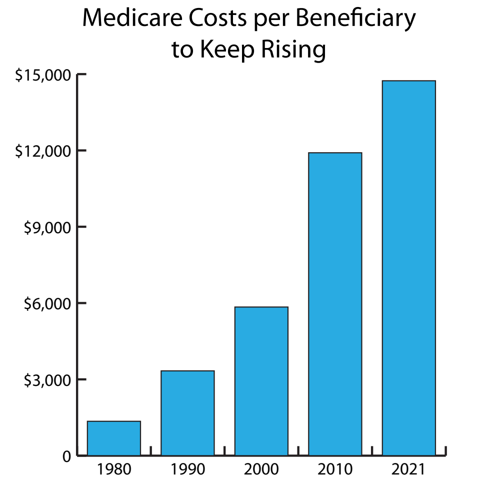
Medicare's Long-Term Sustainability Challenge

Medicare plays a vital role in providing health care benefits to seniors and adults with permanent disabilities—more than 62.6 million Americans in 2020. But the federal government program faces long-term solvency issues. As noted in the 2021 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. In the last year Medicare was significantly affected by the COVID-19 pandemic and recession of 2020, which were not reflected in last year's reports. However, the Trustees Report noted it will have little effect on Medicare's solvency in the long term. Steps must be taken to ensure Medicare's sustainability.



Source: 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 $194.6 billion at the beginning of 2020. HI expenditures in 2020 ($402.2 billion) exceeded HI revenues ($341.7 billion). expenditures (-$60.5 billion) decreased total HI assets to $134.1 billion at the end of 2020. Growth in HI expenditures has averaged 7.6% annually over the past five years, compared with non-interest income growth of 5.2%. Over the next five years, projected average annual growth rates for expenditures and non-interest income are 3.1% and 4.6%, respectively. The SMI trust fund receives about three-quarters of its funding from general revenues and one-quarter from beneficiary premiums. SMI assets totaled $108.8 billion at the beginning of 2020 and grew to $143.3 billion at the end of 2020, as SMI revenues ($558.1 billion) outpaced expenditures ($523.6 billion).

MEDICARE AT A GLANCE IN 2020

Beneficiaries:

- 54.1 million retired workers
- 8.5 million disabled workers and dependents

Expenditures:

- HI—$402.2 billion
- SMI—$523.6 billion
- Total—$925.8 billion

Income:

- HI—$341.7 billion
- SMI—$558.1 billion
- Total—$899.8 billion

Total fund assets:

- HI—$134.1 billion SMI - $143.3 billion
- Total—$277.4 billion

Projected HI Trust Fund depletion date: 2026

Source: 2021 Medicare Trustees Report

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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 91% 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

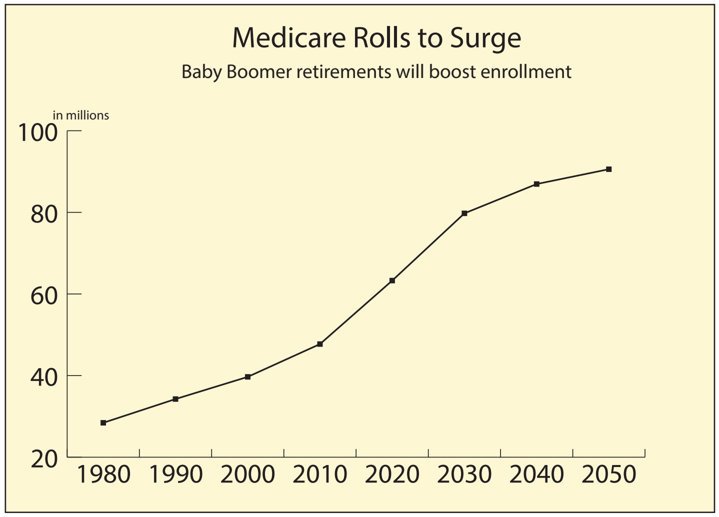
Medicare beneficiary premiums and general tax revenues fund the SMI trust fund, which is expected to remain solvent because the contribution amounts are reset annually. But increased beneficiary premiums (and cost-sharing) are projected to make up increasing shares of Social Security benefits, thus putting 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 2020, Medicare comprised 2.3% of gross domestic product (GDP), a measure of the entire U.S. economy. By 2094, Medicare will take up 4.4% 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.



Source: Medicare Trustees Report

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

Medicare Trust Fund Basics (2021)
https://www.actuary.org/sites/default/files/2021-02/Academy_Medicare_Alliance_Feb25.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