American Academy of Actuaries

Issue Brief

Medicare's Financial Condition: Beyond Actuarial Balance

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Key Points

- The Medicare program faces serious financing challenges:
  - Income to the Hospital Insurance (HI) trust fund is not adequate to fund HI benefits;
  - Increases in costs to the Supplementary Medical Insurance (SMI) Trust Fund increase pressure on beneficiary household budgets and the federal budget; and
  - Increases in total Medicare spending threaten the program's sustainability.
- Changes are needed to improve Medicare's long-term solvency and sustainability. Delaying corrective measures would increase the burden that might be imposed on beneficiaries and taxpayers. Any changes aiming to improve Medicare's financial condition should be considered in light of how they would impact the program's ability to meet the health care needs of beneficiaries.
- The COVID-19 pandemic continues to affect the trust fund projections and increases the uncertainty surrounding the estimates.

Each year, the Boards of Trustees of the Federal Hospital Insurance (HI) and Supplementary Medical Insurance (SMI) trust funds submit a report to Congress on the Medicare program's financial condition. The program is operated through two trust funds. The HI trust fund (Medicare Part A) pays primarily for inpatient hospital services and post-acute care. The SMI trust fund includes accounts for the Medicare Part B program, which covers physician and outpatient hospital services, and the Medicare Part D program, which covers the prescription drug program.

The Medicare Trustees Report is the primary source of information on the financial status of the Medicare program, and the American Academy of Actuaries proudly recognizes the important contribution that members of the actuarial profession have made in preparing the report. Actuaries play a vital role in providing information to the public about the important issues surrounding the program's solvency and sustainability.

The COVID-19 pandemic is continuing to have an effect on the projections. The Trustees assume that non-COVID-related spending will be lower than expected in early 2022 due to the COVID-19 wave in late 2021. Spending is expected to increase later in 2022, and in 2024 health spending patterns are expected to return to pre-pandemic levels. Because beneficiaries with COVID-related deaths had higher-than-average costs, morbidity among surviving beneficiaries is expected to be lower.

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The trustees assume this effect will decline over time and end in 2028. The trustees note the additional uncertainty in the projections due to COVID-19:

> It should be noted that there is an unusually large degree of uncertainty with these COVID-related impacts and that future projections could change significantly as more information becomes available. Moreover, as a result of developments that have occurred since the assumptions for this report were selected in mid-February 2022, uncertainty has increased regarding the path of the COVID-19 pandemic and the economy. The Trustees will continue to monitor developments and modify the projections in later reports as appropriate.

Although most of the findings in the 2022 Medicare Trustees Report are comparable to those in the 2021 report, the 2022 report projects the HI trust fund will be depleted in 2028, two years later than in last year's report. This leaves policymakers only six years to find a solution. The program faces three fundamental long-range financing challenges:

- Income to the HI trust fund is not adequate to fund the HI portion of Medicare benefits;
- Increases in SMI costs increase pressure on beneficiary household budgets and the federal budget; and
- Increases in total Medicare spending threaten the program's sustainability.

The trustees conclude: "The projections in this year's report continue to demonstrate the need for timely and effective action to address Medicare's remaining financial challenges—including the projected depletion of the HI trust fund, this fund's long-range financial imbalance, and the rapid growth in Medicare expenditures."

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In this issue brief, the American Academy of Actuaries' Medicare Committee examines the findings of the Medicare Trustees Report with respect to program solvency and sustainability. The Medicare program continues to face serious financing problems. Due to Medicare's critically important role in ensuring that Americans age 65 and older and certain younger adults with permanent disabilities have access to health care, it is important for policymakers to address the challenges that threaten the program's long-term solvency and financial sustainability. The longer corrective measures are delayed, the worse the financial challenges will become and in turn, the greater the burden that is likely to be imposed on the 2022 report projects the and taxpayers.

Medicare HI Trust Fund Income Falls Short of the Amount Needed To Fund HI Benefits

Medicare's trust funds account for all income and expenditures for the program. The HI and SMI programs operate separate trust funds with different financing mechanisms. Payroll taxes, general revenues, premiums, and other income are credited to the trust funds, which are used to pay benefits and administrative costs. Any unused income is required by law to be invested in U.S. government securities for use in future years. In effect, the trust fund assets represent loans to the U.S. Treasury's general fund. The HI trust fund, which pays for hospital services and post-acute care, is funded primarily through earmarked payroll taxes.

The projections of Medicare's financial outlook in the report are based on current law. The projected HI trust fund exhaustion date is 2028, two years later than projected in last year's Medicare Trustees Report. In addition, the projected 75-year HI deficit decreased—from 0.77% of taxable payroll in the 2021 report to 0.70% in this year's report. The decrease is primarily due to a methodological improvement in the allocation of private health plan payments between the Part A and Part B trust funds and changes in economic and demographic assumptions that were partially offset by hospital and other provider assumptions.

- **HI expenditures are projected to exceed HI revenues**. After experiencing small surpluses in 2016 and 2017, a deficit returned in 2018, 2019, and 2020. The large deficit in 2020 was mostly due to accelerated and advance payments to providers from the HI trust fund. In 2021, there was a small surplus as these payments began to be repaid to the trust fund, and this continued repayment will result in a larger surplus in 2022. Deficits are projected to return in 2023 and persist for the remainder of the projection period. As a result, the HI trust fund assets will need to be redeemed. When the federal government is experiencing unified budget deficits, funding the redemptions requires that additional money be borrowed from the public, thereby increasing the federal deficit and debt.

- **The HI trust fund is projected to be depleted in 2028**. At that time, revenues are projected to cover only 90% of program costs, with the share declining to 80% in 2046 and then increasing to 93% in 2096. There is no current provision allowing for general fund transfers to cover HI expenditures in excess of dedicated payroll taxes.

- **The projected HI deficit over the next 75 years is 0.70% of taxable payroll under intermediate assumptions**. Eliminating this deficit would require an immediate 24% increase in standard payroll taxes or an immediate 15% reduction in expenditures—or some combination of the two. Delaying action would require more severe changes in the future.

The trustees acknowledge that the estimates based on current-law projections could understate the seriousness of Medicare's financial condition, because actual Medicare expenses might exceed current-law estimates. In particular, the trustees and the chief actuary point to scheduled reductions in provider payments that may not occur. Current law requires downward adjustments in payment updates for most non-physician providers to reflect productivity improvements; these adjustments might not be sustainable in the long term. For physician services, not only are updates below the rate of inflation in all future years, but there are more immediate concerns because updates for these services are projected to be –2.9% in 2023 and 0.0% for 2024 and 2025, and certain bonuses paid to physicians are scheduled to expire in 2025. In the Statement of Actuarial Opinion that accompanies the report, the chief actuary of the Centers for Medicare & Medicaid Services (CMS) specifically states, "Should these payment rates prove to be inadequate, beneficiaries' access to and the quality of Medicare benefits would deteriorate over time, or future legislation would need to be enacted that would likely increase program costs beyond those projected under current law in this report."

At the request of the trustees, the CMS Office of the Actuary developed an alternative analysis that provides an illustration of the potential understatement of current-law Medicare cost projections if the productivity adjustments were phased down gradually beginning in 2028 and physician updates were more consistent with cost growth (such changes would require a change in law). Although the illustrative alternative projections are not intended to be interpreted as the official best estimates of future Medicare costs, they do, as noted in the Trustees Report, "help illustrate and quantify the potential magnitude of the cost understatement."

Under the alternative scenario, the HI trust fund still would be depleted in 2028. However, the projected deficit over the next 75 years would be 1.56% of taxable payroll—compared to 0.70% under current-law projections. Eliminating this deficit would require an immediate 54% increase in standard payroll taxes or a 28% reduction in expenditures—or some combination of the two.

Increases in SMI Costs Increase Pressure on Beneficiary Household Budgets and the Federal Budget

The SMI trust fund includes accounts for the Medicare Part B program, which covers physician and outpatient hospital services, and the Medicare Part D program, which covers the prescription drug program. Approximately one-quarter of SMI spending is financed through beneficiary premiums, with federal general tax revenues covering the remaining three-quarters.[1]

The SMI trust fund is expected to remain solvent due to its financing being reset each year to meet projected future costs. As a result, increases in SMI costs will require increases in beneficiary premiums[2] and general revenue contributions. Increases in general revenue contributions will put more pressure on the federal budget. SMI general revenue funding is projected to nearly double from 1.8% of gross domestic product (GDP) in 2021 to 3.1% in 2095.

Premium increases similarly will increase the burden on beneficiaries, especially when considered in conjunction with increasing beneficiary cost-sharing expenses. The average beneficiary expenses (premiums and cost-sharing) for parts B and D combined are currently 23% of the average Social Security benefit. These expenses are projected to increase to 40% of the average Social Security benefit by 2095. These expenses do not include cost-sharing under Part A.

The 2022 Medicare Trustees Report projects that total SMI spending will continue to grow faster than GDP. The total spending will increase from 2.3% of GDP in 2022 to 3.1% of GDP in 2030 and to 4.5% of GDP in 2096.

Spending under the illustrative alternative analysis would be higher, especially in the long term, reflecting the phase-down of productivity adjustments for non-physician provider payments and higher physician updates in the long range. SMI spending projected in the alternative analysis would increase from 2.3% of GDP in 2022 to 3.1% of GDP in 2030 and to 5.5% of GDP in 2096.

1 Premiums for Medicare parts B and D are income-related. Standard premiums are set to cover approximately 25% of program costs. Higher-income beneficiaries pay higher premiums, ranging from 35% of program costs to 85% of program costs.

Many Part D beneficiaries will receive low-income premium subsidies, lowering their premiums below 25% of program costs. In the aggregate, beneficiary premiums will cover only about 14% of total Part D costs in 2022. State payments on behalf of certain beneficiaries will cover about 10% of costs and general revenues will cover the remaining 69% of costs.

2 In 2022, the increase in the Part B premium was especially high, due to the expectations of high utilization for a new injectable drug to treat Alzheimer's disease. However, restrictions on Medicare coverage of the drug resulted in utilization much lower than expected. As a result, the trustees project no increase in the Part B premium for 2023.

Increases in Total Medicare Spending Threaten the Program's Sustainability

A broader issue related to Medicare's financial condition is whether the economy can sustain Medicare spending in the long run. To help gauge the future sustainability of the Medicare program, the trustees consider the share of GDP that will be consumed by Medicare. With Medicare spending expected to continue growing faster than GDP, greater shares of economic growth would be devoted to Medicare over time, meaning smaller shares of the economy would be available for other priorities.

Under current law, Medicare expenditures as a percentage of GDP will grow from 3.9% of GDP in 2021 to 6.5% of GDP in 2096., Under the CMS Office of the Actuary alternative scenario, total Medicare expenditures would increase to 8.6% of GDP in 2096.

Table 1: Total Medicare Expenditures as a Percent of GDP

Calendar Year	2022 Report	2022 Alternative Projection
2021	3.9	3.9
2030	5.0	5.0
2040	6.0	6.2
2050	6.2	6.7
2060	6.3	7.1
2070	6.5	7.7
2080	6.6	8.1
2090	6.5	8.4
2096	6.5	8.6

Sources: 2022 Medicare Trustees Report, CMS Office of the Actuary

Conclusion

Consistent with prior Trustees Reports, the 2022 Medicare Trustees Report stresses the serious financial challenges facing the Medicare program. Although the projected HI trust fund depletion date of 2028 is two years later than projected in last year's report and the 75-year HI deficit has decreased slightly, it remains critical to address the HI shortfall sooner rather than later. In addition, Medicare spending will continue to grow faster than the economy—increasing the pressure on beneficiary household budgets and the federal budget and threatening the program's sustainability.

As noted by the trustees, Medicare's financial challenges could be more severe than projected under current-law assumptions. The report's Medicare spending projections are considered understated to the extent that the Affordable Care Act's provisions for downward adjustments in non-physician provider payment updates to reflect productivity improvements and long-range physician payment updates being held below physician costs are unsustainable in the long term. If Medicare projections are calculated using assumptions that the productivity adjustments are phased down and physician updates are more in line with their costs, Medicare's financial condition is shown to be even worse than under the projected baseline.

The trustees note the urgency of addressing Medicare's financial challenges, stating:

> The Board of Trustees believes that solutions can and must be found to ensure the financial integrity of HI in the short and long term and to reduce the rate of growth in Medicare costs through viable means. The sooner the solutions are enacted, the more flexible and gradual they can be. Moreover, the early introduction of reforms increases the time available for affected individuals and organizations—including health care providers, beneficiaries, and taxpayers—to adjust their expectations and behavior. The Board recommends that Congress and the executive branch work together with a sense of urgency to address these challenges.

Medicare's challenges are not solely financial. Medicare beneficiaries are a diverse segment of the broader population 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 (Medicare Part D) in 2006, Medicare's fee-for-service benefit package has remained mostly unchanged; some services are not 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.