

A Guide to Medicare's Financial Challenges and Options for Improvement

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Summary of Medicare's financial status

- Medicare faces long-term financial challenges
 - Income to the Medicare Hospital Insurance (HI) trust fund is not adequate to fund the HI portion of Medicare benefits
 - Increases in Medicare Supplementary Medical Insurance (SMI) spending increase pressure on beneficiary household budgets and the federal budget
 - Increases in total Medicare spending threaten the program's sustainability
- The Affordable Care Act (ACA) contains provisions designed to improve Medicare's financial condition; nevertheless, additional steps are needed to solve Medicare's financial challenges



Summary of Medicare's financial status (cont.)

- To address Medicare's challenges, spending growth must be reduced
- Criteria for evaluating options to improve Medicare's financial condition include:
 - Impact on cost, access, and quality of care
 - Improving long-term sustainability requires slowing the growth in health spending—rather than shifting costs from one payer to another
 - Payment and delivery systems that better align incentives to encourage integrated and coordinated care have the potential to control costs and improve quality



Understanding Medicare's current challenges: 3 things you need to know

- Medicare's financing structure
- Findings from the 2011 Medicare Trustees Report
- Medicare-related provisions in recent debt- and deficit-reduction proposals



Medicare trust fund structure

	Hospital Insurance (HI)	Supplementary Medical Insurance (SMI)
Benefits	Part A inpatient hospital care	Part B physician and outpatient care; Part D prescription drug benefit
Financing	Payroll taxes	Beneficiary premiums and general tax revenues

Note: Medicare Advantage (MA) plans, also known as Medicare Part C, cover inpatient hospital care as well as physician and outpatient care. They can also cover prescription drugs. MA plans are funded through both the HI and SMI trust funds.



Medicare's financial challenges

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



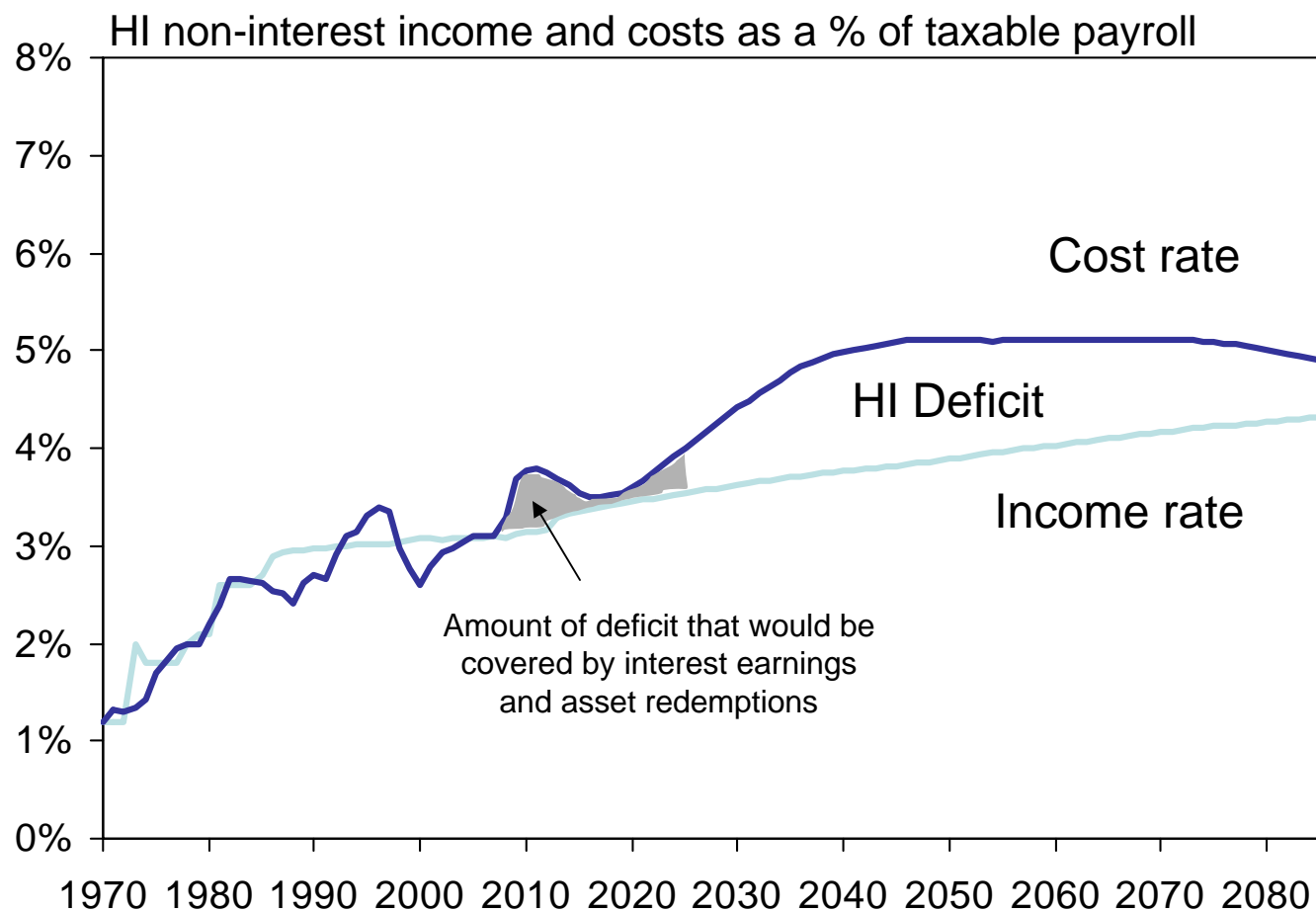
Medicare HI Trust Fund income falls short of the amount needed to fund HI benefits

From the 2011 Medicare Trustees Report:

- In all future years, more money is going out than coming in
- HI trust fund assets, which reflect past excess revenues over expenditures accumulated with interest, will need to be redeemed in order to finance the shortfall
- The HI trust fund is projected to be depleted by 2024



Long-term HI costs and income



Source: 2011 Medicare Trustees Report



Bottom line for HI trust fund: current-law projections

- HI tax revenues will cover 90% of benefits in 2024, when trust fund assets are projected to be depleted
- HI deficit over the next 75 years = 0.79% of taxable payroll
- Eliminating 75-year deficit would require:
 - Immediate 24% increase in payroll taxes, or
 - Immediate 17% reduction in benefits, or
 - Some combination



HI trust fund projections worsen under illustrative alternative scenario

- Trustees' report projections must be based on current-law benefits and revenues
- Projections under a Centers for Medicare and Medicaid Services (CMS) alternative analysis assume the ACA-required reductions in the growth of provider payments will be phased out
- Under the illustrative alternative scenario:
 - HI trust fund would be depleted in 2024
 - HI deficit over the next 75 years = 2.15% of taxable payroll (vs. 0.79% under current law)



Increases in SMI costs increase pressure on beneficiary budgets and the federal budget

- The SMI trust fund will remain solvent, but only because its financing is reset each year to meet projected future costs
- Projected increases in SMI expenditures will require significant increases in beneficiary premiums and general revenue contributions



Current-law projections likely understate SMI expenditures

- Scheduled physician payment reductions in accordance with the sustainable growth rate (SGR) mechanism are unlikely to occur
- Reductions in the growth of provider payments may not be sustainable
- SMI projections under CMS alternative analysis:
 - Replace SGR reductions in physician payment rates with increases that reflect inflation in physician practice costs
 - Phase out the ACA-required downward adjustments to provider payment increases



SMI expenditures as a percent of GDP

Calendar Year	2011 Trustees Report (current law)	2011 Alternative Projection
2010	1.9	1.9
2020	2.3	2.6
2030	3.1	3.7
2040	3.5	4.5
2050	3.6	5.0
2060	3.8	5.5
2070	4.0	6.0
2080	4.1	6.4

Sources: 2011 Medicare Trustees' Report; CMS Office of the Actuary



Increases in total Medicare spending threaten the program's sustainability

- Because Medicare spending is expected to grow faster than GDP, more of the economy will be devoted to Medicare over time
- A smaller part of the economy will be available for other priorities



Total Medicare expenditures as a percent of GDP

Calendar Year	2011 Trustees Report (current law)	2011 Alternative Projection
2010	3.6	3.6
2020	4.0	4.3
2030	5.2	5.9
2040	5.8	7.1
2050	5.9	8.0
2060	6.1	8.8
2070	6.2	9.6
2080	6.3	10.4

Sources: 2011 Medicare Trustees' Report; CMS Office of the Actuary



Policymakers should implement reforms to improve Medicare's outlook

- Congress needs to act to build upon some of the measures already adopted in the ACA
 - The ACA contains provisions designed to reduce costs, increase revenues, and develop new health care delivery systems and payment models that improve health care quality and cost efficiency
- Additional steps are needed to solve Medicare's financial challenges
- The sooner corrective measures are enacted, the more flexible the approach and the more gradual the implementation can be



Major Medicare provisions in the ACA

- A reduction in the growth in provider payments to reflect increases in productivity
- A phase down in Medicare Advantage plan payments to reflect fee-for-service costs
- Health care payment and delivery system improvements (e.g., bundled payments, accountable care organizations)
- An authorization to create the Independent Payment Advisory Board (IPAB)
- An increase in Medicare revenues (e.g., HI payroll tax increases for earnings above threshold, income-related Part D premiums)



Medicare provisions in the ACA (cont.)

- The Congressional Budget Office (CBO) estimates that the Medicare-related provisions in the ACA will reduce spending and increase revenues
- Over a 10 year period (2010-2019)
 - Approximately \$400 billion in Medicare savings
 - Approximately \$100 billion in additional Medicare revenues



Options to improve further Medicare's financial condition

- Medicare-related provisions in recent debt- and deficit-reduction proposals:
 - Limit growth in health spending
 - Transition to a premium support or voucher program
 - Expand authority of the Independent Payment Advisory Board (IPAB)
 - Reform the SGR system
 - Revise fee-for-service (FFS) benefit design and cost-sharing requirements
 - Raise Medicare eligibility age
 - Increase Medicare Part B premiums



Criteria for evaluating options to improve Medicare's financial condition

- Impact on cost, access, and quality
- Improving long-term sustainability requires slowing the growth in health spending—rather than shifting costs from one payer to another
- Payment and delivery systems that better align incentives to encourage integrated and coordinated care have the potential to control costs and improve quality



Option: Limit the growth in health spending

- Set spending targets (e.g., GDP+1%) for Medicare or for all health spending
- If targets exceeded, certain actions are triggered (e.g., automatically reduce benefits or provider payments)
- Cost:
 - Medicare savings would depend on how aggressively (i.e., low) spending targets are set
 - Savings would be offset to the extent that costs are shifted to other payers
- Access/Quality: Would depend on the specific recommendations made



Option: Transition to a premium support or voucher program

- Would change Medicare from defined benefit plan to defined contribution plan
- Federal government would limit amount it contributes toward Medicare coverage (or private plans)
- Beneficiaries would pay the difference between plan premiums and the government contribution



Option: Transition to a premium support or voucher program (cont.)

- Cost: Depending on how contribution is set, federal Medicare spending could be lower than currently projected
 - To extent spending growth exceeds increase in government contribution, costs would be shifted to beneficiaries through higher premiums/cost sharing
 - Could lower spending growth due to reduced utilization
- Access/Quality:
 - Access to coverage depends on difference between government contribution and premium
 - To bring costs down, care quality might be compromised



Option: Expand the authority of the Independent Payment Advisory Board (IPAB)

- IPAB is charged with making recommendations to reduce growth in Medicare per capita expenditures if spending exceeds a targeted growth rate
- IPAB is restricted regarding what changes it can recommend
- Option would expand scope of the IPAB by removing some restrictions on its recommendations and/or giving it authority over all federal health spending
 - Expansion of scope could be tied to more aggressive (i.e., low) spending targets



Option: Expand the authority of the IPAB (cont.)

- Cost: To the extent that spending growth targets are lowered, more cost savings could be achieved
- Access/Quality: Depends on specific recommendations made



Option: Reform the Sustainable Growth Rate (SGR) system

- SGR formula adjusts physician payment increases by comparing actual cumulative physician spending to a specified target
- Physician fee cuts of 27% scheduled for 2012
- Concerns regarding SGR system include:
 - Reduced beneficiary access under large fee cuts
 - Provider frustration over short-term nature of payment fixes
 - Growing budgetary costs of further overrides
- Option would eliminate SGR and develop a new physician payment system



Option: Reform the SGR (cont.)

- Cost: Eliminating SGR would increase Medicare spending projections unless offset by other spending reductions
- Access/Quality:
 - Could help maintain access to care
 - New payment system could better align payments with provision of high-value care



Option: Reduce spending for prescription drugs

- Options include:
 - Require Medicare to negotiate drug prices under Part D
 - Extend drug rebates to dual eligibles
 - Establish a government-run Part D option
- Cost: By reducing prescription drug prices, would lower Part D spending and beneficiary premiums
- Access/Quality:
 - Could reduce pharmaceutical research and development
 - Government-run Part D option could lead to private plans leaving the market, reducing enrollee choice



Option: Revise fee-for-service (FFS) benefit design and cost-sharing requirements

- Concerns regarding current FFS plan design:
 - Deductibles are higher for inpatient care
 - Most beneficiaries have supplemental policies, reducing incentives to seek cost-effective care
 - Lack of cost-sharing limit
- Options include:
 - Combine Parts A and B cost-sharing and add cost-sharing limit
 - Eliminate first-dollar coverage in Medigap plans or levy excise tax on plans with first-dollar coverage
 - Move more toward value-based insurance design



Option: Revise FFS benefit design and cost-sharing requirements (cont.)

- Cost:
 - Increasing cost-sharing requirements could reduce Medicare spending, but shift costs to beneficiaries
 - Savings also from reduced utilization
- Access/Quality:
 - Could better align beneficiary incentives for high-quality, cost-effective care
 - Low-income and chronically ill more sensitive to cost-sharing increases



Option: Raise the Medicare eligibility age

- Normal retirement age for Social Security has been increased to age 67 and some proposals would increase it further
- Similar options would increase Medicare eligibility age and/or index it for increased longevity



Option: Raise the Medicare eligibility age (cont.)

- Cost:
 - Would reduce Medicare costs
 - Savings would be offset by increased federal spending in other areas (e.g., premium subsidies through exchanges, Medicaid)
- Access/Quality:
 - People between age 65 and new eligibility age would have to find new source of coverage
 - ACA provisions would increase the availability of other coverage sources



Option: Increase Part B premiums

- Current premiums set at 25% of costs
 - Beginning in 2007, higher-income beneficiaries pay between 35% and 80% of costs, depending on income
- Options would increase Part B premiums for those not already subject to higher premiums or raise them higher for those who are
- Cost: Would increase Medicare revenues by shifting costs to beneficiaries; would not affect Medicare spending
- Access/Quality: Beneficiaries unwilling or unable to pay higher Part B premiums might face reduced access to care



Bottom line: key considerations

- Improving long-term sustainability requires slowing the growth in health spending rather than shifting costs from one payer to another
- Payment and delivery systems that better align incentives to encourage integrated and coordinated care have the potential to control costs and improve quality



What can you do?

- Understand that there isn't a simple solution to shoring up Medicare's financial condition
 - Ensuring that Medicare benefits are payable in the future may require shared responsibility from Medicare beneficiaries, taxpayers, and health care providers
- Learn as much as you can about the Medicare program and its financial challenges
- Urge your elected officials to make Medicare a priority and address its financial challenges sooner, rather than later



Resources from the American Academy of Actuaries

- Medicare's financial condition
 - *Medicare's Financial Condition: Beyond Actuarial Balance* (Issue brief, May 2011)
 - *An Actuarial Perspective on Proposals to Improve Medicare's Financial Condition* (Issue brief, May 2011)
 - Testimony to House Ways and Means Committee hearing on the 2011 Medicare Trustees Report (June 2011)
 - Letter to Joint Select Committee on Deficit Reduction urging it to develop sound public policy proposals to improve the long-term solvency and sustainability of the Medicare program (August 2011)



Resources from the American Academy of Actuaries (cont.)

- Accountable care organizations
 - *An Actuarial Perspective on Accountable Care Organizations* (Issue brief, June 2011)
- Comparative effectiveness
 - *Health Insurance Coverage and Reimbursement Decisions: Implications for Increased Comparative Effectiveness Research* (Issue brief, Sept 2008)
- Value-based insurance design
 - *Value-based Insurance Design* (Issue brief, June 2009)



Resources from the American Academy of Actuaries (cont.)

- All publications from the American Academy of Actuaries are available at www.actuary.org
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