

**THE STATUS OF THE MEDICARE PART A AND PART B TRUST FUNDS:
THE TRUSTEES' YEAR 2000 REPORTS (REVISED)**

I. Introduction

Financial transactions of the Medicare program operate through two Trust Funds. The Federal Hospital Insurance (HI) Trust Fund finances Medicare Part A, which covers inpatient hospital, home health,¹ skilled nursing facility, psychiatric hospital, and hospice care services. The Supplementary Medical Insurance (SMI) Trust Fund finances Part B, which covers physician visits, outpatient services, some mental health services, durable medical equipment, some preventive services, and home health visits not covered under Part A.² This *Data Digest* summarizes the current and projected financial status of these Trust Funds, as determined by the Trustees in their year 2000 reports to Congress.

The Trustees assess the status of each Trust Fund under three scenarios (pessimistic, intermediate, and optimistic), each of which uses different sets of assumptions about such factors as general and health care inflation, wage growth, mortality, and fertility rates. *Unless otherwise noted, the information presented in this Data Digest represents the Trustees' intermediate estimates, commonly referred to as the actuaries' "best guess."*³

II. The Federal Hospital Insurance (HI) Trust Fund—Medicare Part A

The Trustees of the HI Trust Fund examine the Fund's financial health by comparing its *projected income* with its *projected expenditures*. The primary source of income for the Part A Fund is a 2.9 percent payroll tax paid by employers and employees (1.45% each). Self-employed individuals pay 2.9 percent of wages.⁴

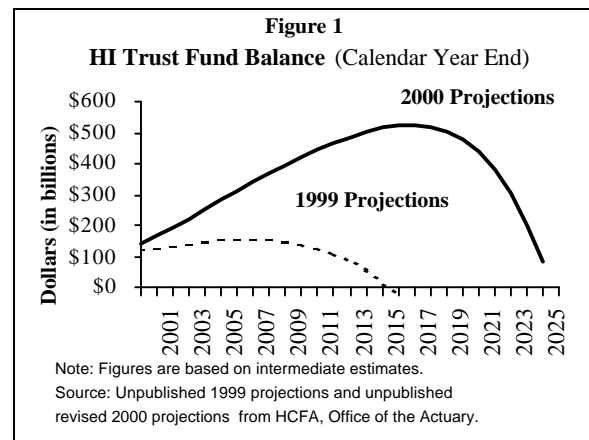
The Trustees report that the Fund's annual income in 1999 exceeded annual spending for Part A services by \$21 billion. Expenditures were \$130.6 billion, and income (from payroll taxes and other sources) was \$151.6 billion. On December 31, 1999, HI Trust Fund reserves stood at \$141.4 billion.

Short-Term Financial Status

The Trustees project that the HI Trust Fund will remain solvent until 2025, ten years later than projected in their 1999 report. This extended period of solvency is largely due to higher income and lower Part A spending than projected in their 1999 report.

The increase in income is attributed to robust economic growth, particularly growth in the labor market. The Trustees attribute the decrease in Part A spending to: (1) the continuing implementation of measures in the Balanced Budget Act of 1997 (BBA);⁵ (2) a reduction in the growth of health care costs in general; (3) ongoing efforts to reduce fraud and abuse; and (4) a substantial drop in the utilization of home health care services.

The Trustees project that Part A income will exceed expenditures each year between 2000 and 2016. Beginning in 2017, annual expenditures will exceed annual income, thereby reducing and ultimately depleting the Trust Fund reserves in the year 2025. Figure 1 illustrates projections of the Fund's financial status through 2024.⁶

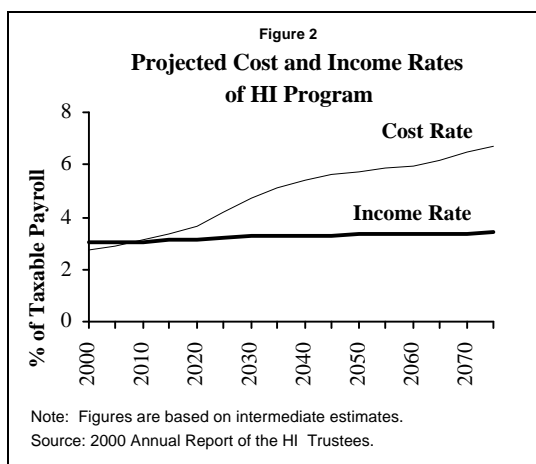


Under the Trustees' pessimistic scenario, insolvency would occur in 2012. Under the Trustees' optimistic scenario, annual trust fund income would exceed expenditures for at least the next 75 years.

Long-Term Financial Status

The Trustees also look at the financial health of the HI Trust Fund for the next 25, 50, and 75 years. For this long-term analysis, income and costs are expressed as a percentage of taxable payroll (hereafter referred to as the *income rate* and *cost rate*, respectively).

As shown in Figure 2, the long-term gap between the projected income rate and cost rate has been reduced somewhat from the 1999 projections. Despite this improvement, the income rate will remain virtually constant while the cost rate will grow over time.



To test the long-range financial health of the Trust Fund, the Trustees examine its *actuarial balance*, which is a summary of the differences between the annual income rate and cost rate over a period of years (i.e., 25, 50, or 75 years).⁷ A negative actuarial balance means the fund has a deficit and fails the Trustees' test of financial health.

The Trustees project that, over a 75-year period, the Part A Trust Fund will have an actuarial balance deficit of 1.21 percent of taxable payroll. To demonstrate the severity of this deficit, the Trustees project that achieving actuarial balance would require either increasing the current payroll tax to 4.11 percent, reducing expenditures by a comparable amount, or some combination of the two measures. Under the optimistic scenario, the Trust Fund has a positive actuarial balance, which indicates that income would cover program expenses over the next 75 years. By contrast, under the pessimistic scenario, the cost rate is more than twice the

income rate over this time period. The vast differences in these projections illustrate the uncertainty of predicting future spending as well as the impact of economic and demographic conditions.

In addition, the ratio of workers paying payroll taxes to the number of beneficiaries enrolled will steadily decline as baby boomers become eligible for Medicare and life expectancy continues to increase. While there were 4.0 workers paying for each beneficiary's HI benefit in 1999, there will be only 2.3 workers per beneficiary in 2030, when all of the baby boomers will have reached age 65.

III. The Federal Supplementary Medical Insurance (SMI) Trust Fund—Medicare Part B

The Trustees of the SMI Trust Fund do not assess the Fund's financial health in the same manner as they do with the HI Trust Fund because of key differences in how the two Funds operate. Income for the SMI Trust Fund comes primarily from federal general revenues and beneficiary premiums. General revenues finance about 75 percent of program spending, while beneficiary premiums cover about 25 percent.⁸

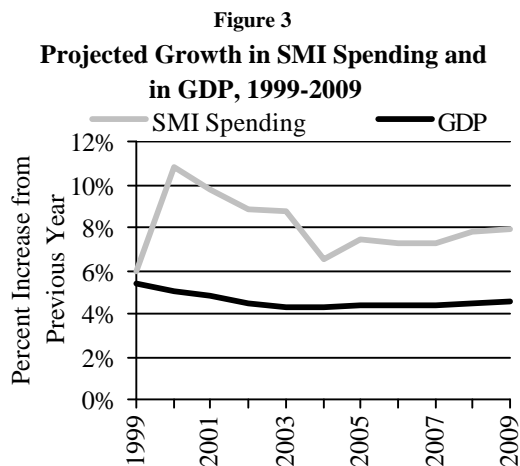
Similar to Part A, SMI income and benefit payments are funnelled through its Trust Fund. However, in the SMI Trust Fund, income from the federal government is adjusted each year to ensure that all expenses are covered. Therefore, by statute and its structure, the SMI Trust Fund can never be depleted, unlike the HI Trust Fund. Furthermore, income from the government is estimated prospectively, so the reserves in the SMI Trust Fund fluctuate, depending on the difference between estimated spending and actual experience.

The Trustees report that, in 1999, expenditures from the SMI Trust Fund were \$82.3 billion. Federal general revenues financed 73 percent of these expenditures, and premiums covered 23 percent (See Footnote 8). Interest and other miscellaneous income paid the remaining 4 percent. As of December 31, 1999, the balance of the SMI Trust Fund was \$44.8 billion.

Short-Term and Long-Term Financial Status

The Trustees report that the SMI Trust Fund will remain adequately financed into the indefinite future because of the automatic yearly financing from the government. The Trustees' current projections of Part B expenditures over the next decade are lower than previously forecasted because actual Part B spending in 1999, as well as the growth in the volume and intensity of services, were lower than the Trustees projected last year.

However, despite the favorable economic news, the Trustees express concern about the *rate of growth* of Part B spending. Between 1994 and 1999, expenditures increased by 38 percent, or about 5 percent faster than the economy as a whole (as measured by growth in the Gross Domestic Product, or GDP). Although the rate of growth during 1999 was among the lowest ever experienced, the Trustees expect that Part B spending will continue to increase significantly faster than the economy through 2009 (see Figure 3) and beyond.



Note: Because of the gradual transfer of some home health costs from Part A, the Trustees expected a lag in 1999 Part B home health payments; this lag results in larger than usual expenditures in 2000.

SMI spending does not include administrative costs.

Source: 2000 Annual Report of the SMI Trustees and 2000 CBO Economic Projections.

The Trustees also calculate Part B expenditures as a percentage of GDP to examine the potential impact on the economy.⁹ From 1966 through 1999, Part B expenditures were less than 1 percent of GDP. SMI expenditures are expected to increase to 2.13 percent of GDP by 2030 and to 2.36 percent by 2075. Such a trend means that Part B expenditures can be expected to consume growing shares of our country's productivity.

The Trustees predict that Part B spending will grow rapidly over the next decade, in part, because of increases in the volume and intensity of services provided per beneficiary. After 2010, the influx of baby boomers will also greatly influence the increase in spending.

Under the Trustees' more pessimistic assumptions, Part B spending would grow much more rapidly than the GDP even beyond 2009. Under the Trustees' more optimistic assumptions, expenditures would grow faster than GDP for only a few years, then slow to about the same rate of increase as the GDP.

Impact on Beneficiaries and on Taxpayers

Because beneficiaries' premiums finance about 25 percent of Part B, any increase in expenditures would result in higher beneficiary Part B premiums. The Trustees estimate that, in 1999, about 6 percent of a typical 65-year-old beneficiary's Social Security benefit was withheld to pay the monthly Medicare Part B premium. By 2019, 10 percent of the same beneficiary's Social Security benefit would need to be withheld.

In fiscal year 1999, the federal general revenues required to cover Part B expenditures were equivalent to 5.8 percent of the personal and corporate income taxes collected. The Trustees project that, in 2075, if these taxes remain at their current level, the federal general revenues needed to finance SMI expenditures could equal about 15 percent of total income taxes.

IV. The Medicare HI and SMI Programs Combined

The Trustees report that, under current law, the Medicare program will consume a greater share of our national income in the future. In 1999, the Medicare program as a whole accounted for about 2.3 percent of our national income (again, as measured by GDP). They project that the HI and SMI programs combined will increase to almost 4 percent of GDP by 2025 and to more than 5 percent of GDP by 2075. (The Trustees acknowledge, however, that projecting forward so far into the future is difficult.)

V. Trustees' Conclusions

The short-term outlook of the HI Trust Fund has improved substantially since the 1999 report. However, that Fund's long-term financial status remains problematic. The Trust Fund surpluses forecast over the next several years result from an unexpectedly favorable economic climate. If these conditions change, deficits could return sooner than projected.

By design, the SMI Trust Fund is financially solvent into the indefinite future. Due to favorable economic conditions, SMI spending is projected to be lower than previously forecast. However, the Trustees remain concerned about the growth rate of SMI spending, which continues to increase faster than GDP.

The Trustees urge policymakers to use the time gained by the later depletion of the HI Trust Fund productively to solve the Fund's long-term problems. They also recommend that policymakers explore effective means of controlling SMI spending and address the financial impact of the impending retirement of the baby boom generation.

The Trustees find the recent and widespread interest of policymakers in Medicare's financial status encouraging. However, policymakers must take effective and decisive action in both Parts A and B to build upon the strong steps taken in recent reforms.

¹ Medicare Part A covers up to 100 home health visits following a hospital stay of at least three days.

² Part B covers visits not preceded by a hospital stay and visits over the 100-day Part A limit.

³ Unless otherwise noted, all figures are calendar year estimates.

⁴ In 1999, payroll taxes made up about 87 percent of the HI Trust Fund's income. Additional sources of income include interest on federal securities, taxation of a portion of Social Security benefits, premiums paid by voluntary enrollees, and government credits.

⁵ The BBA reduced payments to hospitals, established new payment methodologies for home health agencies and skilled nursing facilities, and shifted certain home health costs from Part A to Part B. The BBA did not enact measures to increase income to the Trust Fund.

⁶ The Trustees do not publish annual projections of the Trust Fund balance beyond a 10-year period.

⁷ The actuarial balance is adjusted to include the beginning fund balance and the cost of ending the projection period with a fund balance equal to estimated spending for the following year.

⁸ The premium rates between 1998 and 2003 will cover less than 25 percent of actual program costs, as a result of the gradual phase-in of the transfer of some home health costs from Part A to Part B.

⁹ Includes benefit payments and administrative expenses.

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