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Committee on Oversight and Government Reform
U.S. House of Representatives

Financial Status of the Medicare Program

Mr. Chairman, Mr. Davis, and members of the subcommittee, I appreciate the invitation to appear before you today.

Although Medicare faces significant financing challenges, claims that the program is nearing "bankruptcy" are highly misleading. The 2011 report of Medicare's trustees shows little change from last year's report in the financial outlook for the program. Partly because the trustees now foresee a modestly slower economic recovery that will reduce Medicare payroll tax revenues relative to earlier estimates, they estimate that Medicare's Hospital Insurance (HI) trust fund will be depleted in 2024 — five years sooner than they projected last year.

Even at the point of depletion, however, payroll taxes and other dedicated revenues will still be sufficient to pay *90 percent* of HI costs. HI will not be completely lacking in resources, although additional revenues or programmatic changes clearly will be needed to restore financial balance. And the 2024 date applies only to Medicare's Hospital Insurance trust fund and not to the Supplementary Medical Insurance (SMI) trust fund, which finances physician services and prescription drug coverage. SMI is always adequately financed because beneficiary premiums and general revenue contributions are set annually to cover expected costs for the coming year. By construction, SMI cannot run short of money — or go "bankrupt."

The trustees' near-term projections are broadly in line with those they have issued in the past. Since 1990, changes in the law, the economy, and other factors have moved the projected year of HI insolvency from as close as four years to as far as 28 years away. Trustees' reports have been projecting insolvency for four decades, but Medicare benefits have always been paid because Congress has taken steps to make sure that they are. The rapid evolution of the health care system has required frequent adjustments to Medicare, as it has to private health insurance, and that pattern is certain to continue.

Although the trustees again project that 45 percent or more of Medicare funding will come from general revenues within six years, this finding bears no relation whatever to Medicare's solvency. The Medicare Modernization Act of 2003 established a process for issuing a "Medicare funding warning" when the share of Medicare financing from general revenues is projected to exceed 45 percent. The 45-percent level, however, is a completely arbitrary benchmark that is entirely unrelated to the financial health of the program. By its very design, Medicare is supposed to be financed in significant part with general revenues. That at least 45 percent of Medicare will be financed with general revenues is no more a problem than that 100 percent of defense, education, or most other federal programs is financed with general revenues.

Over the next 25 years total Medicare spending is projected to grow at about the same rate as the trustees forecast previously — from 3.6 percent of gross domestic product (GDP) in 2010 to 5.6 percent of GDP in 2035. Much of this projected increase stems from the aging of the baby boomers, the first of whom become eligible for Medicare this year. This shift in the age distribution of the population has long been anticipated and inevitably brings with it an increase in health care spending, since health care needs and costs increase as people get older.

Last year's health reform legislation (the Affordable Care Act, or ACA) significantly improved Medicare's long-term cost outlook. Over the next ten years, Medicare spending per beneficiary is projected to grow by 3.0 percent a year, well below both its average of 7.8 percent a year over the previous decade and also the projected rate of growth of private health care costs. Under the trustees' main projection, the HI program's 75-year shortfall is 0.79 percent of taxable payroll — up from last year's estimate of 0.66 percent of payroll, but much less than without health reform.

If health reform were repealed, the Medicare actuary has estimated that HI's insolvency date would be moved up eight years, to 2016. Without health reform, HI's long-term shortfall would increase from 0.79 percent to 3.89 percent of taxable payroll.

These projections emphasize the importance of successfully implementing the cost-control provisions of the Affordable Care Act. While history shows that most major Medicare savings measures have been implemented as scheduled, the Medicare actuary has expressed concern that some of the ACA's savings provisions may not be sustainable. The actuary urges reliance instead on an "illustrative alternative" projection for Medicare, which assumes that only 60 percent of the ACA's Medicare savings will be achieved in the long run. Using this alternative projection would not affect the projected insolvency of the Hospital Insurance trust fund, which would still occur in 2024, but the 75-year shortfall in the fund would rise to 2.15 percent of payroll — about 2¾ times higher than the trustees' official estimate. This is still a dramatic improvement, however, over the situation *prior* to the Affordable Care Act.

Despite the improvements made by the Affordable Care Act, Medicare continues to face significant long-term financial challenges, stemming from the aging of the population and the continued rise in health care costs throughout the U.S. health care system, which contributes to the bleak federal fiscal outlook. It is essential that policymakers take further substantial steps to curb the growth of health costs throughout the U.S. health care system as we learn more about how to do so effectively in both public programs and private-sector health care. In particular, the Medicare research and pilot projects the ACA establishes should yield important lessons.

In the near term — before these efforts bear fruit— it will be difficult to achieve big additional reductions in Medicare expenditures without shifting substantial costs to beneficiaries or greatly reducing payments to providers, either of which would likely endanger access to care for low- and moderate-income beneficiaries. Extending the life of the HI trust fund will almost certainly require *both* increases in HI revenues *and* further reductions in projected Medicare expenditures.

Phasing out traditional Medicare and replacing it with private health insurance, as the House-passed budget resolution would do, would represent a big step in the wrong direction. It would increase total health care spending attributable to Medicare beneficiaries (the beneficiaries' share plus the government's share) by upwards of 40 percent, according to the Congressional Budget Office. It would also reduce the federal government's contribution to cover those costs. As a result, it would massively shift costs to the beneficiaries — that is, the elderly and persons with disabilities.

Traditional Medicare — not private health insurance — has been the leader in instituting various reforms in the health care payment system to improve efficiency. Partly because of its record of innovation, Medicare has outperformed private insurance in holding down the growth of health costs. Between 1970 and 2009, Medicare spending per enrollee grew by an average of 1 percentage point less each year than comparable private health insurance premiums. Under health reform, Medicare will continue to lead the way in efforts to slow health care costs while improving the quality of care. By eliminating traditional Medicare, the House-passed plan would discard the opportunity to use the program to promote cost reduction throughout the health care system. Americans should not be driven into adopting such a radical proposal by incorrect claims that Medicare is on the verge of "bankruptcy."