July 2015 | Fact Sheet

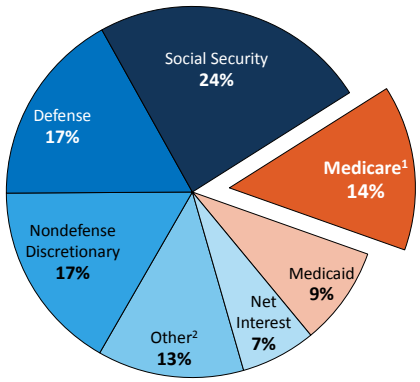
The Facts on Medicare Spending and Financing

Overview of Medicare Spending

Medicare, the federal health insurance program for 55 million people ages 65 and over and people with permanent disabilities, helps to pay for hospital and physician visits, prescription drugs, and other acute and post-acute services. In 2014, spending on Medicare accounted for 14% of the federal budget **(Figure 1)**. Medicare plays a major role in the health care system, accounting for 22% of total national health spending in 2013, 26% of spending on hospital care, and 22% of spending on physician services.[1] This fact sheet includes the most recent historical and projected Medicare spending data from the 2015 annual report of the Medicare Trustees[2] and the 2015 Medicare baseline from the Congressional Budget Office.[3]

Figure 1

Medicare as a Share of the Federal Budget, 2014



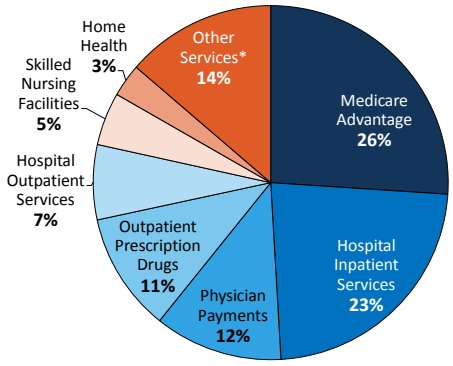
Total Federal Outlays, 2014 = $3.5 Trillion
Net Federal Medicare Outlays, 2014 = $505 Billion

NOTE: All amounts are for federal fiscal year 2014. [1]Consists of Medicare spending minus income from premiums and other offsetting receipts. [2]includes spending on other mandatory outlays minus income from offsetting receipts).
SOURCE: Congressional Budget Office, Updated Budget Projections: 2015 to 2025 (March 2015).

Medicare benefit payments totaled $597 billion in 2014; roughly one-fourth was for hospital inpatient services, 12% for physician services, and 11% for the Part D drug benefit **(Figure 2)**. Another one-fourth of benefit spending was for Medicare Advantage private health plans covering all Part A and Part B benefits; in 2015, 31% of Medicare beneficiaries are enrolled in Medicare Advantage plans.[4]

Figure 2

Medicare Benefit Payments, 2014



Total Medicare Benefit Payments, 2014 = $597 billion

NOTE: *Consists of Medicare benefit spending on hospice, durable medical equipment, Part B drugs, outpatient dialysis, ambulance, lab services, and other Part B services; also includes the effect of sequestration on spending for Medicare benefits and amounts paid to providers and recovered.
SOURCE: Congressional Budget Office, 2015 Medicare Baseline (March 2015).

Both in the aggregate and on a per capita basis, Medicare spending growth has slowed in recent years and is expected to grow relatively slowly in the future compared to historical trends. Net Medicare spending is projected to grow modestly as a share of the federal budget and the nation's economy in the coming decade.

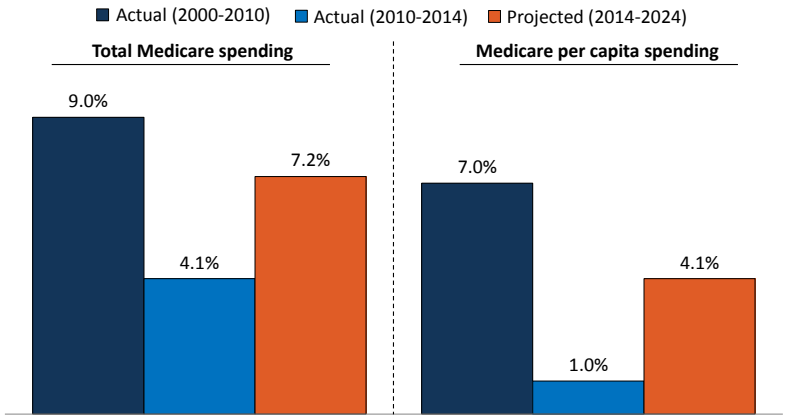
Historical and Recent Trends in Medicare Spending

On a historical basis, Medicare spending per enrollee grew at an average annual rate of 7.5% between 1969 and 2013, slower than the 9.1% average annual growth rate in private health insurance spending per enrollee, according to the Centers for Medicare & Medicaid Services (CMS) Office of the Actuary (OACT).[5] This comparison includes benefits commonly covered by Medicare and private health insurance over this period, including hospital services, physician and clinical services, and other professional services, and durable medical products.

In the last five years, total and per capita Medicare spending have grown more slowly than in the previous decade. Annual growth in total Medicare spending averaged 4.1% between 2010 and 2014, compared to 9.0% between 2000 and 2010, based on data from OACT, despite growth in the number of beneficiaries and increases in health care costs over these years **(Figure 3)**. Spending per beneficiary was lower than total program spending in both time periods; per capita spending growth averaged just 1.0% between 2010 and 2014, compared to 7.0% between 2000 and 2010.

Figure 3

Actual and Projected Average Annual Growth Rate in Medicare Total and Per Capita Spending



SOURCE: Kaiser Family Foundation analysis of Medicare spending data from the 2015 Annual Report of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds..

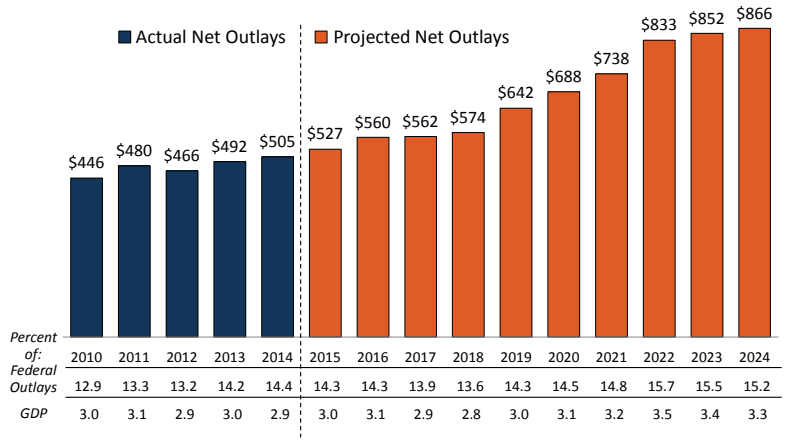
Based on a comparison of CBO's August 2010 and March 2015 baselines, Medicare spending in 2015 will be about $1,200 lower per person than was expected in 2010, soon after passage of the Affordable Care Act (ACA). Medicare spending projections in CBO's August 2010 and subsequent baselines take into account the anticipated effects of the ACA, which included reductions in Medicare payments to plans and providers and introduced delivery system reforms that aimed to improve efficiency and quality of patient care and reduce costs, including accountable care organizations (ACOs), medical homes, bundled payments, and value-based purchasing initiatives. The law also increased the Medicare Part A payroll tax rate on earnings for higher-income people and increased Part B and Part D premiums for higher-income beneficiaries. In addition, the Budget Control Act of 2011 lowered Medicare spending through sequestration that reduced payments to providers and plans by 2% beginning in 2013.

Future Trends in Medicare Spending

Looking ahead, net Medicare outlays (that is, Medicare spending minus income from premiums and other offsetting receipts) are projected to increase from $527 billion in 2015 to $866 billion in 2024, according to CBO **(Figure 4)**; CBO projects total Medicare outlays to increase from $632 billion in 2015 to $1.1 trillion in 2024.[6] CBO's short-term estimates, however, do not take into account the spending effects of changes to Medicare's physician payment system brought about by the Medicare Access and CHIP Reauthorization Act of 2015 (MACRA), a new law to repeal and replace Medicare's Sustainable Growth Rate (SGR) formula. These effects are incorporated, however, in the most recent Medicare spending projections from OACT. Over the next decade, OACT projects that total Medicare spending will increase from $649 billion in 2015 to $1.2 trillion in 2024.[7]

Figure 4

Actual and Projected Net Medicare Spending, 2010-2024



	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Percent of: Federal Outlays	12.9	13.3	13.2	14.2	14.4	14.3	14.3	13.9	13.6	14.3	14.5	14.8	15.7	15.5	15.2
GDP	3.0	3.1	2.9	3.0	2.9	3.0	3.1	2.9	2.8	3.0	3.1	3.2	3.5	3.4	3.3

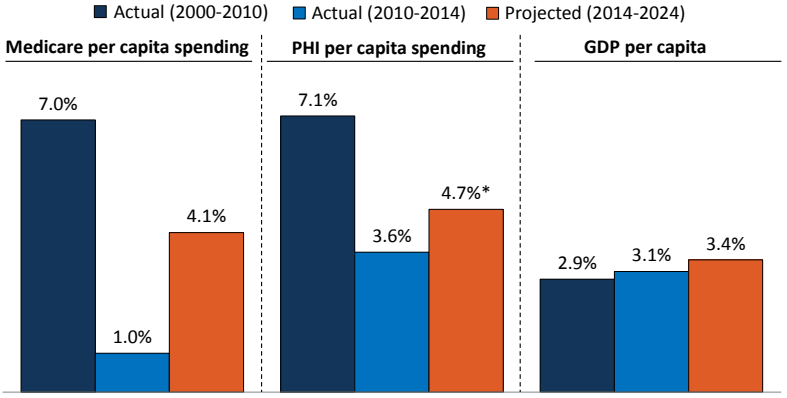
NOTE: All amounts are for federal fiscal years; amounts are in billions and consist of Medicare spending minus income from premiums and other offsetting receipts.
SOURCE: Congressional Budget Office, Updated Budget Projections: 2015 to 2025 (March 2015); The 2015 Long-Term Budget Outlook (June 2015).

Net Medicare spending is projected to grow modestly as a share of the federal budget and the nation's economy in the coming decade. Medicare's share of the federal budget is projected to increase from 14.3% in 2015 to 15.2% in 2024, while Medicare spending as a share of GDP is projected to increase from 3.0% in 2015 to 3.3% in 2024 **(Figure 4)**.

On a per capita basis, Medicare spending is projected to grow at a faster rate between 2014 and 2024 (4.1%) than it did between 2010 and 2014 (1.0%), but is expected to grow more slowly in the coming years than per capita private health insurance spending (4.7%) **(Figure 5)**. Per capita spending is not expected to grow uniformly across the decade, however. Medicare per capita spending growth is expected to be slower in the first five years of the projection period (3.3% between 2014 and 2019) than in the last five years (5.0% between 2019 and 2024). Spending growth also is not projected to be the same for each part of the Medicare program. Between 2014 and 2024, per capita spending growth is projected to be higher for Part D (5.7%) than for Part A (3.0%) or Part B (4.7%). OACT expects a comparatively higher per capita growth rate in the coming years for Part D than for the other parts of the program due to higher costs associated with expensive specialty drugs.

Figure 5

Actual and Projected Average Annual Growth Rate in Medicare Per Capita Spending and Other Measures



NOTE: PHI is private health insurance. *Projected for 2014-2023.
SOURCE: Kaiser Family Foundation analysis of Medicare spending data from Boards of Trustees; private health insurance spending data from the CMS National Health Expenditure data; GDP data from BEA (historical) and CBO (projected), and CPI data from the BLS (historical) and CBO (projected).

Over the 2014-2024 time period, the rate of Medicare per capita spending growth is expected to be 0.7 percentage points larger than projected growth in GDP per capita, while private health insurance per capita spending is expected to grow 1.3 percentage points faster **(Figure 5)**. Over the longer term (that is, beyond the next ten years), both CBO and OACT expect Medicare spending to rise more rapidly relative to GDP due to a number of factors, including the aging of the population and faster growth in health care costs than growth in the economy on a per capita basis. OACT has lowered its long-term Medicare spending projections, however, compared to 2014 projections, due in part to legislative changes, including MACRA, and lower assumptions for long-range health care cost growth, among other factors.

According to CBO's most recent long-term projections (which incorporate the estimated effects of MACRA), net Medicare spending will grow from 3.0% of GDP in 2015 to 4.2% of GDP in 2030, 5.1% in 2040, and 5.9% in 2050. Over the next 25 years, CBO projects that the aging of the population will account for a somewhat smaller share of spending growth (43%) on the nation's major health care programs (Medicare, Medicaid, and subsidies for ACA Marketplace coverage) than "excess" health care spending growth (45%), while the expansion of Medicaid and Marketplace subsidies accounts for the remaining 12%.[8]

How Is Medicare Financed?

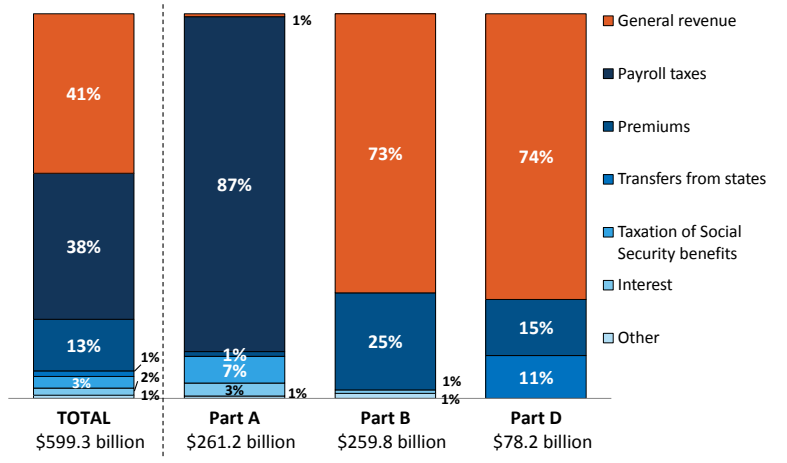
Medicare is funded primarily from three sources: general revenues (41%), payroll taxes (38%), and beneficiary premiums (13%) **(Figure 6)**.

Part A is financed primarily through a 2.9% tax on earnings paid by employers and employees (1.45% each) (accounting for 87% of Part A revenue). Higher-income taxpayers (more than $200,000/individual and $250,000/couple) pay a higher payroll tax on earnings (2.35%).

Part B is financed through general revenues (73%), beneficiary premiums (25%), and interest and other sources (2%). Beneficiaries with annual incomes over $85,000/individual or $170,000/couple pay a

Figure 6

Sources of Medicare Revenue, 2014



NOTE: Data are for the calendar year.
SOURCE: 2015 Annual Report of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds.

higher, income-related Part B premium reflecting a larger share of total Part B spending, ranging from 35% to 80%. The ACA froze the income thresholds through 2019, and beginning in 2020, the income thresholds will once again be indexed to inflation, based on their levels in 2019 (a provision in MACRA). As a result, the number and share of beneficiaries paying income-related premiums will increase as the number of people on Medicare continues to grow in future years and as their incomes rise.

Part D is financed through general revenues (74%), beneficiary premiums (15%), and state payments for dual eligibles (11%). Similar to Part B, enrollees with higher incomes pay a larger share of the cost of Part D coverage.

The Medicare Advantage program (Part C) is not separately financed. Medicare Advantage plans such as HMOs and PPOs cover all Part A, Part B, and (typically) Part D benefits. Beneficiaries enrolled in Medicare Advantage plans typically pay monthly premiums for additional benefits covered by their plan in addition to the Part B premium.

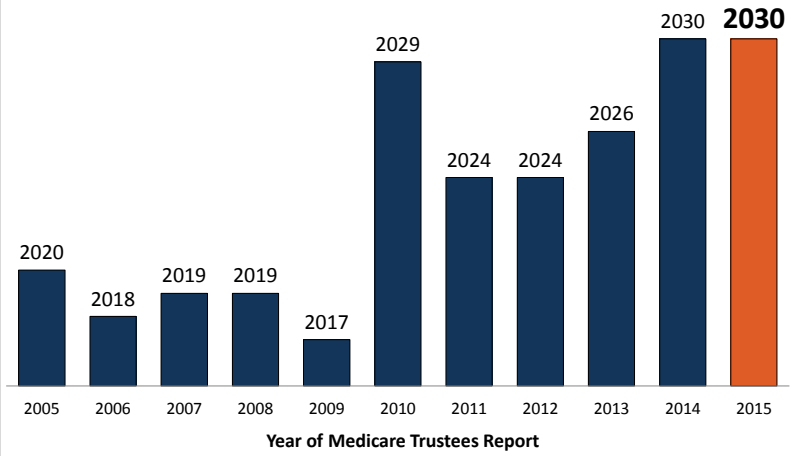
Solvency of the Medicare Hospital Insurance Trust Fund

The solvency of the Medicare Hospital Insurance trust fund, out of which Part A benefits are paid, is a common way of measuring Medicare's financial status. Solvency is measured by the level of assets in the Part A trust fund. In years when annual income to the trust fund exceeds benefits spending, the asset level increases, and when annual spending exceeds income, the asset level decreases. When spending exceeds income and the assets are fully depleted, Medicare will not have sufficient funds to pay all Part A benefits.

Each year, the Medicare Trustees provide an estimate of the year when the asset level is projected to be fully depleted. Because of slower growth in Medicare spending in recent years, the solvency of the trust fund has been extended. In 2015, the Trustees project that the Part A trust fund will be depleted in 2030, the same year as was projected in the 2014 report and four years later than was projected in the 2013 report **(Figure 7)**.

Figure 7

Solvency Projections of the Medicare Part A Trust Fund, 2005-2015



SOURCE: Intermediate projections from 2005-2015 Annual Reports of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds.

Part A Trust Fund solvency is affected by growth in the economy, which affects revenue from payroll tax contributions, health care spending trends, and demographic trends: an increasing number of beneficiaries, especially between 2010 and 2030 when the baby boom generation reaches Medicare eligibility age, and a declining ratio of workers per beneficiary making payroll tax contributions.

Part B and Part D do not have financing challenges similar to Part A, because both are funded by beneficiary premiums and general revenues that are set annually to match expected outlays. However, future increases in spending under Part B and Part D will require increases in general revenue funding and higher premiums paid by beneficiaries.

In addition to the solvency of the Part A trust fund, Medicare's financial condition can be measured in other ways. For example, the Independent Payment Advisory Board (IPAB), which was authorized by the ACA, is required to recommend Medicare spending reductions to Congress if projected spending growth exceeds specified target levels. IPAB is required to propose spending reductions if the 5-year average growth rate in Medicare per capita spending is projected to exceed the per capita target growth rate, based on inflation (2015-2019) or growth in the economy (2020 and beyond). Based on its most recent Medicare spending growth rate projections relative to the targets, OACT has estimated that the IPAB process will trigger modest Medicare spending reductions in 2019, 2024, 2026, 2028, and 2033, but not in the years beyond that. CBO has projected that Medicare spending growth will be below the target growth rate for each year through 2024, but will exceed the target in 2025.

FUTURE OUTLOOK

While Medicare spending is on a slower upward trajectory now than in past decades, total and per capita annual growth rates appear to be edging away from their historically low levels of the past few years. Several questions remain unanswered about recent trends in Medicare spending and what they portend about future spending levels: What are the primary reasons for the recent slowdown beyond the expected effects of the ACA? How are payment and delivery system reforms influencing spending levels? How will Medicare's new physician payment systems affect future Medicare spending growth? Can the recent slowdown in Medicare spending be sustained and can this be done without adversely affecting access to or quality of care?

To address the health care financing challenges posed by the aging of the population, a number of changes to Medicare have been proposed, including: restructuring Medicare benefits and cost sharing; eliminating "first-dollar" Medigap coverage; further increasing Medicare premiums for beneficiaries with relatively high incomes; raising the Medicare eligibility age; shifting Medicare from a defined benefit structure to a "premium support" system; and accelerating the ACA's delivery system reforms. The prospects for these specific proposals are unclear, but few would question the importance of thoughtful deliberation of these and other ways to bolster the Medicare program for an aging population.

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[1] Centers for Medicare & Medicaid Services, Office of the Actuary, National Health Statistics Group, National Health Expenditures Tables (December 2014).

[2] *2015 Annual Report of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds*, July 22, 2015.

[3] Congressional Budget Office, *March 2015 Medicare Baseline*, March 9, 2015.

[4] Gretchen Jacobson, Anthony Damico, Tricia Neuman, and Marsha Gold, "Medicare Advantage 2015 Spotlight: Enrollment Market Update," Kaiser Family Foundation, June 2015.

[5] Centers for Medicare & Medicaid Services, Office of the Actuary, National Health Statistics Group, National Health Expenditures Tables (December 2014).

[6] Congressional Budget Office, *March 2015 Medicare Baseline*, March 9, 2015.

[7] *2015 Annual Report of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds*, July 22, 2015, Table V.B1.

[8] Congressional Budget Office, *The 2015 Long-Term Budget Outlook*, June 2015.