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The 2007 Medicare Trustees Report: A Trigger for Reform?

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Last week, the Medicare Trustees issued their annual report on the financial status of Medicare. While there were some short-term improvements since last year's report, the trustees indicated once again that Medicare's current structure is fiscally unsustainable. The trustees issued the first official "Medicare funding warning," triggering a legal requirement for the President to propose, and Congress to consider on an expedited basis, legislation to address Medicare's rapidly growing costs. Congress should heed the funding warning and adopt the Medicare reforms in the President's most recent budget proposal. Beyond these reforms, the legislative response to the trigger should transcend program adjustments and fundamentally reform Medicare.

What the Report Says. Medicare is funded by a combination of dedicated revenues (payroll taxes, beneficiary premiums, and state payments) and general revenues. Medicare's Hospital Insurance (HI) trust fund, financed by payroll taxes, is currently running a deficit and is projected to be exhausted by 2019, one year later than previously estimated. Conversely, the Supplementary Medical Insurance (SMI) trust funds, Medicare Part B and Part D which cover outpatient services and prescription drugs, never face a deficit nor become exhausted, because annual adjustments are made each year—mainly drawing more from general revenues—to match expected costs. In their report, the trustees explain that Medicare Part D, the new drug benefit, is expected to cost significantly less than initially estimated in the short-term, principally confirming the positive effects of market competition and consumer choice in Medicare. Nevertheless, with projected increased demands on the Medicare program in general by retiring baby boomers and rising health costs, growth in program expenditures, which are already heavily reliant on general revenues, will soon require an unsustainable amount of taxpayer funding.

The Medicare Trustees report shows that Medicare poses the single greatest challenge to taxpayers of all government programs.[1] In 2006, total Medicare expenditures were $408 billion, or approximately 3.1 percent of GDP. But as a share of GDP, Medicare expenditures are projected to double to 6.5 percent by 2030 and nearly quadruple to 11.3 percent by 2081. The trustees estimate that Medicare's total unfunded obligations amount to $34.2 trillion over the next 75 years. According to public trustee Thomas R. Saving, even if Medicare remained at its current size as a share of GDP, the program would still face $25 trillion in unfunded obligations over the next 75 years, nearly five times the size of outstanding public debt today.[2] Absent reform, Saving estimates Medicare will consume 37.1 percent of federal income taxes in 2030 and as much as 76.4 percent of federal income taxes in 2081.[3] Saving also projects federal income taxes would have to increase 22.7 percent in 2030 and

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59.5 percent by 2081 just to maintain other government expenditures at their current levels while meeting Medicare's unfunded obligations.[4] Clearly, the status quo for Medicare is fiscally unsustainable.

What the Law Requires. Under the Medicare Modernization Act of 2003, Congress set a trigger to address Medicare's unfunded obligations. If more than 45 percent of Medicare expenditures are projected to come from general revenues (as opposed to premiums and other dedicated revenues) within a seven-year actuarial period, the trustees would issue an "excess general revenue Medicare funding" determination in their annual report. By law, two consecutive "excess general revenue Medicare funding" determinations would produce a "Medicare funding warning," triggering action by the President and Congress. The President would be legally required to address the funding warning in legislation within 15 days of the next budget, and the proposal would receive expedited consideration in Congress. Given the projected rapid growth in Medicare expenditures, the trustees were forced to issue "excess general revenue Medicare funding" determinations last year and this year, requiring them to issue the first "Medicare funding warning."

Steps for Reform. Although the "Medicare funding warning" triggers a legislative response by the next budget, in the meantime Congress should embrace the President's proposed Medicare reforms to begin to reduce the program's unfunded obligations.[5] The Office of Management and Budget predicts the President's proposal would reduce unfunded obligations by $65.6 billion over five years and $8 trillion over 75 years, which is almost one-fourth of the total projected unfunded obligations over that period.[6] According to Secretary of Health and Human Services Michael Leavitt, had the President's proposal been enacted, it would have delayed the trustees' "Medicare funding warning" and extended the solvency of the HI trust fund by four years.[7]

Although the President's proposal is a bold first step in reducing unfunded obligations, it alone would not resolve Medicare's financial troubles. To go the necessary steps, the administration and Congress should use the trigger and the resulting legislative response to transform Medicare from the existing disintegrated system of benefits based on central planning and price controls into a new, integrated system of defined contributions, or premium support, based on market competition and consumer choice.

Without restructuring Medicare, the program will continue to promote perverse incentives for overuse and require arbitrary payment cuts to seek to control costs. A premium support model, in contrast, would create systemic incentives for both beneficiaries and providers to seek appropriate, efficient outcomes which, in the long-term, improve quality and restrain costs through consumer choice and competition among private plans. Premium support in Medicare would work much like the Federal Employees Health Benefits Program (FEHBP), which is far superior to the current Medicare program in quality of care, performance, efficiency, and cost control.

Conclusion. The trustees report, despite some minor improvements since last year, shows that the rapid growth in Medicare expenditures is fiscally unsustainable. If Congress is at all serious about fiscal responsibility, it must act now by embracing the President's recent budget proposal. Further, the trustees' funding warning should trigger reform that fundamentally restructures the Medicare program.

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1. "2007 Annual Report of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds," Washington, D.C., April 23, 2007, at *www.cms.hhs.gov/ReportsTrustFunds/*.
2. Thomas R. Saving, "The Current State of Social Security and Medicare: The 2007 Trustees Report," Private Enterprise Research Center Texas A&M and National Center for Policy Analysis, at *www.ncpa.org/pub/special/pdf/2007_trustees_analysis.pdf*.
3. *Ibid.*
4. *Ibid.*
5. The primary provisions of the President's plan would limit taxpayer subsidizes to wealthy beneficiaries, extend Part B means testing to Part D, and reduce certain Medicare payments.
6. Office of Management and Budget, Budget of The United States Government, Fiscal Year 2008, February 2007, p. 64.
7. Centers for Medicare and Medicaid Services, "Medicare Trustees Release Annual Report," April 23, 2007, at *www.cms.hhs.gov/apps/media/press/release.asp?Counter=2120*