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FORTHCOMING MEDICARE TRUSTEES' REPORT MAY CONTAIN DUBIOUS "MEDICARE FUNDING WARNING"

By Robert Greenstein and James Horney

While Medicare faces a serious long-term financing problem that must be addressed, the annual report of the Social Security and Medicare trustees to be released on April 23 may contain a dubious "Medicare Funding Warning" that is based on a deeply misleading measure of the program's health.

Under a last-minute provision slipped into the 2003 Medicare prescription drug bill, the Medicare trustees are required to estimate in their annual report on the program's financial status whether general fund revenues will pay for more than 45 percent of total Medicare expenditures in any of the next six years.¹ The law also requires that if two consecutive trustees' reports estimate that the 45-percent threshold will be exceeded, a "Medicare Funding Warning" must be issued and the President must submit, and Congress must consider, proposals to prevent the threshold from being reached.

Last year's Trustees' report contained a projection that the threshold would be exceeded in 2012. If this year's report projects the threshold will be exceeded in any year through 2013, this "trigger" will be pulled.

Unfortunately, the 45-percent threshold misdefines the basic challenge facing Medicare — which is how *much* the program is projected to cost, not what *share* of that cost comes from any given revenue source. Medicare was specifically designed to be financed in substantial part by general revenues rather than payroll taxes, in part because the latter are regressive. Payroll taxes fund only the hospital insurance part of Medicare (Medicare Part A). The physicians' insurance and outpatient services part of Medicare (Part B) and the new prescription drug benefit (Part D) are both funded by general revenues. That

KEY FINDINGS

- The Social Security and Medicare Trustees report may project, for the second year in a row, that general revenues will make up more than 45 percent of Medicare funding within six years. Under a provision of the 2003 prescription drug law, this would trigger a requirement that the President submit, and Congress consider, proposals to keep that threshold from being exceeded.
- The 45-percent threshold is not a meaningful measure of the health of Medicare. Medicare's basic problem is its large projected cost, not what *share* of that cost comes from general revenues rather than payroll taxes.
- The threshold also makes it harder to address Medicare's fiscal problems fairly. It rules out increases in progressive taxes as part of Medicare reform but allows increases in regressive payroll taxes and beneficiary premiums, as well as cuts in Medicare benefits.

¹ For more details on this provision see Robert Greenstein *et al.*, "Trustees' Report Focuses Attention on Misguided Medicare '45-Percent Trigger,'" Center on Budget and Policy Priorities, revised May 1, 2006.

more than 45 percent of Medicare financing may come from general revenues poses no more of a problem by itself than the fact that *100 percent* of the financing for defense, veterans' benefits, education, health research, or most other federal programs comes from general revenues.

The share of Medicare costs that is financed by general revenues is rising, for several reasons. Medicare costs have been growing faster than the economy for some time and are projected to continue doing so, largely because of rising costs throughout the entire U.S. health care system, both public and private. (The aging of the population is also raising Medicare costs.) Payroll taxes, in contrast, tend to grow somewhat *more slowly* than the economy. So, the share of total Medicare spending that is covered by payroll taxes has been shrinking, while the share covered by general revenues has been expanding. This trend is expected to continue indefinitely.

Congress accelerated Medicare's growing reliance on general revenues when it decided to fund the new Medicare prescription drug benefit with general revenues (and beneficiary premiums), rather than with additional payroll taxes. For these reasons, the 45-percent threshold will be reached in the near future, even if Medicare costs turn out to rise much more slowly than is currently projected.

An even bigger problem with the 45-percent threshold is that it impedes action to improve the long-term outlook for Medicare. The financing problems that Medicare faces are sufficiently large that a number of steps will have to be taken; there will be no single silver bullet here. Changes in the nation's overall health care system, reforms in Medicare, itself, *and* additional general revenues *all* will almost certainly be needed. Marilyn Moon, a former Social Security and Medicare trustee who is widely regarded as one of the nation's leading Medicare experts, has observed that we "probably cannot . . . keep a viable Medicare program without tax increases at some point in the future."²

Yet as Moon has pointed out, the 45-percent threshold "limits the options you have to finding a solution" to Medicare's financing problems.³ For example, it would effectively rule out an increase in progressive income taxes as a part of a long-term solution for Medicare, since an increase in general revenues would conflict with keeping the general-fund share of Medicare financing from rising above 45 percent. Thus, Congress would be barred from closing a modest share of Medicare's funding gap by scaling back the \$160,000 average annual tax cut enacted in 2001 and 2003 for people with incomes of \$1 million or more. Congress would even be barred from securing more funding for Medicare by closing abusive corporate tax shelters.

In contrast, Congress would be permitted to raise regressive payroll taxes, hike the monthly premiums that beneficiaries are charged, and cut the health services that Medicare covers, as well as cut reimbursements to providers.

In short, the 45-percent threshold represent an ideologically driven approach to Medicare's financing woes that protects the nation's most affluent residents at the expense of Medicare beneficiaries and working families of more modest means. Thoughtful observers should focus on the real Medicare issues the forthcoming trustees' report raises, not on a dubious "Medicare Funding Warning" that is devoid of analytic merit and that, if followed, would not only impede efforts to address Medicare's problems, but also exacerbate inequality.

² Statements by Marilyn Moon come from presentations and comments by Moon in two audio-conferences sponsored by the Center on Budget and Policy Priorities on March 23, 2004. Transcriptions are available from the Center.

³ Ibid.