CBO TESTIMONY

Statement of
Paul N. Van de Water
Assistant Director
for Budget Analysis
Congressional Budget Office

on
The Financial Status of the Medicare Program

before the
Subcommittee on Health
Committee on Ways and Means
U.S. House of Representatives

April 30, 1996

NOTICE

This statement is not available for public release until it is delivered at 2:00 p.m. (EDT) on Tuesday, April 30, 1996.

CONGRESSIONAL BUDGET OFFICE
SECOND AND D STREETS, S.W.
WASHINGTON, D.C. 20515

Mr. Chairman and Members of the Subcommittee, it is my pleasure to be here today to discuss the financial status of the Medicare program, particularly the Hospital Insurance (HI) trust fund.

Continuing growth in the cost of providing Medicare coverage to each beneficiary, coupled with a steady increase in the number of beneficiaries, is eroding the financial status of the program. Spending for Hospital Insurance and Supplementary Medical Insurance (SMI) combined has increased from 0.8 percent of gross domestic product (GDP) in 1975 to 2.5 percent in 1995. The Congressional Budget Office (CBO) projects that if current law is not changed, Medicare spending will increase to 3.8 percent of GDP by 2006. Program revenues, however, are not increasing nearly as rapidly. If left unchecked, those trends will create a problem of major proportions when the baby-boom generation begins to reach retirement age in 2010.

CBO'S BASELINE PROJECTIONS

In 1995, spending for Medicare benefits and administrative expenses totaled $180 billion, including both the Hospital Insurance and Supplementary Medical Insurance programs. Under current law, CBO projects that Medicare spending will

double by 2003 and increase to $468 billion by 2006 (the last year for which CBO prepares detailed projections). That growth represents an average annual rate of increase of 9.1 percent over the 1995-2006 period (see Table 1).

The growth in Medicare spending projected by CBO is broad based. HI outlays, which include spending for inpatient hospital care, home health services, skilled nursing facilities (SNFs), and a share of premiums for beneficiaries enrolled in capitated health maintenance organizations (HMOs), are projected to increase at an average annual rate of 8.3 percent. SMI, which pays for physicians' services, labs, durable medical equipment, outpatient hospital services, and the remaining share of premiums for beneficiaries enrolled in risk plans, is projected to increase at an average annual rate of 10.3 percent.

For both HI and SMI, payments to risk-based HMOs are the fastest-growing component. Most of that growth, however, is attributable to rapidly increasing enrollment. CBO projects that enrollment in risk plans will increase 25 percent in 1996, with the rate of growth slowing to 10 percent in 1999 and subsequent years. CBO also projects that the number of Medicare enrollees in the traditional fee-for-service sector will actually decline over this period. Despite that decline in fee-for-service enrollment, however, payments for home health, SNFs, and outpatient

TABLE 1. PROJECTIONS OF MEDICARE OUTLAYS (By fiscal year, in billions of dollars)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	Average Annual Percentage Rate of Growth, 1995-2006
Hospital Insurance	115	127	139	152	164	177	190	204	220	237	255	275	8.3
Supplementary Medical Insurance	65	72	79	88	97	106	116	128	141	156	173	192	10.3
Gross Outlays	180	199	219	240	261	283	307	332	361	393	428	468	9.1
Premium Receipts	-20	-20	-21	-23	-24	-25	-26	-27	-29	-30	-31	-32	4.3
Net Outlays	160	179	198	217	237	258	281	305	332	363	397	435	9.5

SOURCE: Congressional Budget Office.

NOTE: Numbers may not add up to totals because of rounding.

hospital services are still projected to grow at double-digit rates. The growth in spending for those services partly reflects successful efforts to constrain the growth in spending for inpatient hospital services.

STATUS OF THE HOSPITAL INSURANCE TRUST FUND

The financial transactions of the HI and SMI programs are handled through two separate trust funds on the books of the Treasury. The trust fund technique involves earmarking specific taxes or other revenues for financing certain programs. That procedure helps to weigh the costs and benefits of the programs and gives beneficiaries some assurance that their benefits will be protected.

Financial soundness is not an issue for the SMI trust fund because the portion of spending not financed by premiums is covered by an open-ended appropriation from the general fund of the Treasury. The HI trust fund, however, does not have a tap on general revenues and is facing depletion within five years.

In 1995, spending for Hospital Insurance exceeded by a small amount earmarked payroll and income taxes and other income to the trust fund. CBO

projects that outgo will exceed income by $7 billion in 1996. With HI outlays increasing more quickly than payroll tax receipts, the gap will widen each year, and the HI trust fund will become insolvent in 2001 (see Table 2).

COMPARISON WITH PREVIOUS PROJECTIONS

CBO has slightly modified its projections for Medicare over the past year. Overall, CBO's April 1996 projections for Medicare spending are lower than its March 1995 projections. Although CBO has reduced projected levels of spending for SMI, it has upped its projections for HI, and the projected insolvency of the HI trust fund has moved forward by one year.

In March of last year, CBO projected total spending of $463 billion in 2005, compared with a current projection of $428 billion. Most of the decrease stems from changes in projected spending for the SMI program. For 2005, CBO has reduced projected SMI spending from $216 billion to $173 billion. That decline reflects two factors: a lower base--actual 1995 spending was $2 billion lower than CBO's March 1995 projection--and a lower projected rate of growth. The lower projected rate of growth recognizes a slowdown in SMI spending over the past several years.

TABLE 2. BASELINE PROJECTIONS OF THE MEDICARE HOSPITAL INSURANCE TRUST FUND
(By fiscal year, in billions of dollars)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
						April 1996 Baseline						
Outgo	115	127	139	152	164	177	190	204	220	237	255	275
Income												
Payroll taxes[a]	104	110	117	122	129	136	142	150	157	165	173	182
Interest	11	10	9	7	5	3	b	-2	-6	-10	-14	-19
Total	115	120	126	130	134	139	143	147	151	155	159	163
Surplus or Deficit	b	-7	-13	-22	-30	-38	-48	-57	-68	-82	-96	-112
Fund Balance[c]	130	122	109	87	57	19	-29	-86	-154	-236	-332	-444
						December 1995 Baseline						
Outgo	115	126	138	149	161	173	186	200	214	231	248	n.a.
Income												
Payroll taxes[a]	104	109	115	121	127	134	140	147	154	161	169	n.a.
Interest	11	10	9	8	7	5	3	b	-3	-7	-12	n.a.
Total	115	120	124	129	134	139	143	147	151	154	157	n.a.
Surplus or Deficit	b	-7	-13	-20	-27	-34	-43	-53	-64	-77	-91	n.a.
Fund Balance[c]	130	123	109	89	62	28	-15	-68	-132	-208	-299	n.a.
						August 1995 Baseline						
Outgo	114	125	137	148	160	172	185	199	214	230	247	n.a.
Income												
Payroll taxes[a]	104	110	115	121	128	135	142	150	158	167	176	n.a.
Interest	10	10	9	8	6	4	2	-2	-6	-11	-17	n.a.
Total	114	120	124	129	134	140	144	149	152	156	159	n.a.
Surplus or Deficit	b	-5	-13	-19	-26	-33	-41	-51	-61	-74	-89	n.a.
Fund Balance[c]	129	124	112	93	67	34	-7	-58	-119	-194	-282	n.a.
						March 1995 Baseline						
Outgo	114	125	137	148	160	172	185	199	214	230	247	n.a.
Income												
Payroll taxes[a]	106	113	118	124	131	138	145	153	161	170	179	n.a.
Interest	10	10	10	9	7	6	3	b	-3	-7	-12	n.a.
Total	117	123	127	133	138	143	148	153	158	163	167	n.a.
Surplus or Deficit	3	-2	-9	-15	-22	-29	-37	-46	-56	-67	-80	n.a.
Fund Balance[c]	132	129	120	105	83	53	16	-30	-85	-152	-233	n.a.

SOURCE: Congressional Budget Office.

NOTE: n.a. = not available. Numbers may not add up to totals because of rounding.

a. Includes a small amount of premiums and other noninterest income.
b. Less than $500 million.
c. At the end of the fiscal year.

In contrast, CBO's current projections of HI spending exceed those of a year ago. In March 1995, CBO projected HI outlays of $247 billion in 2005; our current projection is $255 billion. That change primarily reflects an increase in actual 1995 outlays, which came in about $1 billion higher than CBO's original projection. Although complete information is not yet available, we attribute much of that increase to higher-than-expected hospital admissions and a change in the mix of cases. Because it is not clear whether this trend will continue, we did not significantly change our projected rates of growth in HI outlays for the out-years.

In March 1995, CBO projected that the HI trust fund would run a $3 billion surplus in 1995 and that outlays would exceed receipts beginning in 1996. In fact, HI outlays in 1995 slightly exceeded income to the trust fund. That change reflects the higher-than-projected HI outlays noted above and lower-than-projected receipts.

CONCLUSION

The change from a surplus to a deficit in the HI trust fund in 1995 has recently received a great deal of attention. Given the size of the HI program and the uncertainty that surrounds even short-run projections of outlays and revenues,

however, that change provides little new information about appropriate directions for Medicare policy. At this point, apart from total outlays, we know very little about recent developments in health benefits paid by the HI program.

Similarly, the advance of one year in the projected date of insolvency should be viewed not as telling us something new but confirming what we already know: Medicare spending continues to grow at rates signficantly in excess of the payroll and other tax revenues used to pay for benefits.

As the Members of this Subcommittee recognize, fixing Medicare's financing problems will not be easy. Either taxes must be increased, expenditures reduced, or both, and the magnitudes involved are large. To ensure solvency of the HI trust fund just through 2006 would require an increase in the HI payroll tax of 0.7 percentage points--about 25 percent--starting in January. Alternatively, the rate of growth of HI outlays would have to be slowed by more than 3 percentage points--from 8 percent to about 4½ percent a year. Larger changes would be required to bring the growth of SMI spending in line with the growth of the economy. Postponing action would make the necessary policy actions even more severe.