

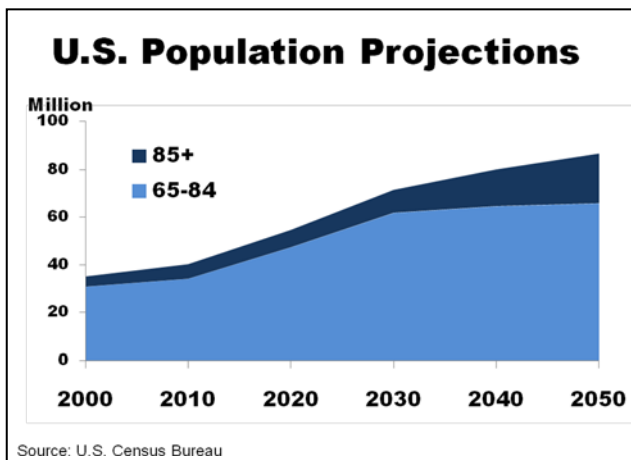
MEDICARE: Challenges Facing the Next President

Introduction

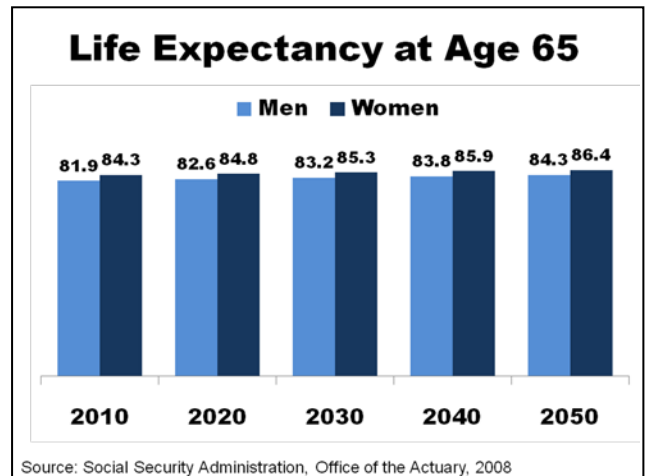
Notwithstanding its popularity and positive results, Medicare faces daunting challenges in the near future. Over the next three decades, there will be a pronounced shift in the demographic profile of the United States. We will experience unprecedented growth in the 65-year and older population, as the Baby Boom generation ages. The prevalence of chronic conditions among seniors is rising, as is life expectancy. And, the proportion of the elderly who are racial minorities will approach majority.

These demographic shifts could result in longer and healthier lives for Americans. But they also will strain the financial sustainability of Medicare, as the net effect of these changes will be an increase in spending. Escalating health care costs are not a new phenomenon; however, the risks associated with the demographic transition are unprecedented. Without considerable modifications to the program or a significant increase in its financing, Medicare will not be able to continue to provide accessible, affordable health coverage to its beneficiaries.

Shifting Demographics and Health



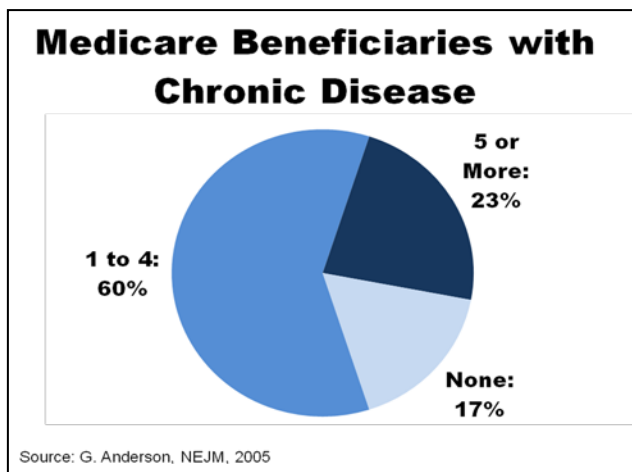
The Population is Aging. The elderly population – individuals age 65 and older – is expected to double between 2000 and 2030.¹ The elderly will comprise 20 percent of the population in 2030, compared to only 12 percent in 2000.² As of 2008, the first wave of the Baby Boomers was eligible for Social Security benefits, and starting in 2011 they will be eligible for Medicare benefits. Consequently, the number of Medicare beneficiaries is projected to climb from 44.9 million to 78.6 million by 2030, a 75 percent increase.³



The Elderly are Living Longer. Compounding the growth of the elderly population is the rise in life expectancy. Life expectancy at the age of 65 has increased 30 percent from 1960 to 2004, from 79.3 to 83.7 years old.⁴ Government actuaries expect the lengthening of seniors' lives to continue.⁵ Additionally, there were only approximately 4.3 million people age 85 and older in 2000. That number is expected to balloon over 20 million by the year 2050.⁶ Therefore, Medicare will not only be covering more people, but covering them for longer periods of time.

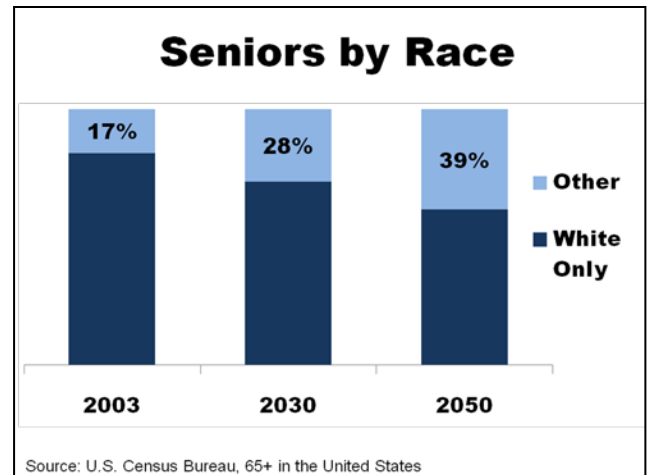
Chronic Conditions Are Spreading. The prevalence of chronic diseases in America has significant implications for our health care system. An estimated 133 million Americans have at least one chronic condition; this could rise to nearly half of the population by 2030.⁷ Medicare beneficiaries are particularly vulnerable to this problem and these trends. In 2005, 83 percent of all Medicare beneficiaries reported having at least one chronic condition. Of these, 23 percent of beneficiaries had five or more chronic conditions. These beneficiaries have greater health care needs, averaging thirteen physician visits and fifty filled prescriptions.⁸

Chronic disease is a major driver of costs. The 23 percent of beneficiaries with five or more chronic conditions accounted for 68 percent of Medicare spending in 2005.⁹ Between 1987 and 2002, virtually all of Medicare's spending growth could be attributed to people with five or more conditions.¹⁰ Personal health spending per capita on chronic conditions by Medicare beneficiaries increased at an average annual rate of 5 percent between 1992 and 2004.¹¹



Demographics of Seniors is Changing. Reflecting broader trends, the elderly population is expected to become more diverse as the Baby Boom population retires. In 2003, 83 percent of the 65 and over population was white (non-Hispanic). However, this figure is expected to drop to 61 percent by 2050.¹² Proportionally the Hispanic population is projected to grow at the fastest rate. From 2003 to 2050, the Hispanic population as a percent of the elderly will double to 18 percent.¹³

The gender composition of the elderly population is also shifting. The male-female ratio (males per 100 females) in 2000 was 70, and by 2050 this figure jumps to 79.¹⁴ Although women will still make-up a greater portion of the elderly population in 2050, the percent who are men will increase by approximately 12 percent cumulatively. In 2002, Medicare expenditures per beneficiary were slightly higher for men than women overall, however this partly reflects the greater likelihood that men have private supplemental coverage.¹⁵



One area of uncertainty is projected trends in work among the elderly. The sheer size of the elderly population will mean that their proportion of the workforce will rise. In 2003, people ages 65 and older comprised 3.3 percent of the civilian workforce; this is projected to rise to 5.0 percent by 2020.¹⁶ However, many factors will affect whether seniors are willing and able to work and how.

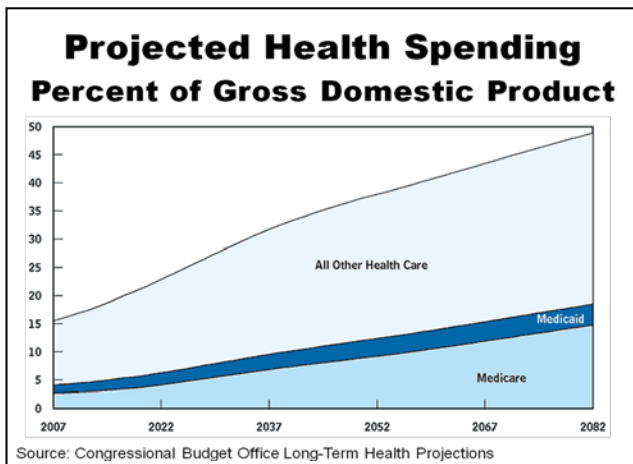
Fewer Workers Will Support Retirees. The number of labor force participants supporting retiree benefits is expected to shrink. In 1960, prior to the enactment of Medicare, the covered worker to retiree ratio was 5.1 to 1.¹⁷ Today, this ratio is 3.3 to 1, and is expected to fall rapidly as baby boomers retire in large numbers. Without any significant shifts in immigration rates, only 2.4 workers will fund the social security and Medicare benefits of each retiree in 2030. With reference to worker-to-retiree ratio, Alan Greenspan noted that, "short of an outsized acceleration of productivity to well beyond the average pace of the past seven years or a major expansion of immigration, the aging of the population now in train will end this state of relative budget tranquility in about a decade's time."¹⁸

Surging Health Care Cost

Health Cost Growth and the Economy.

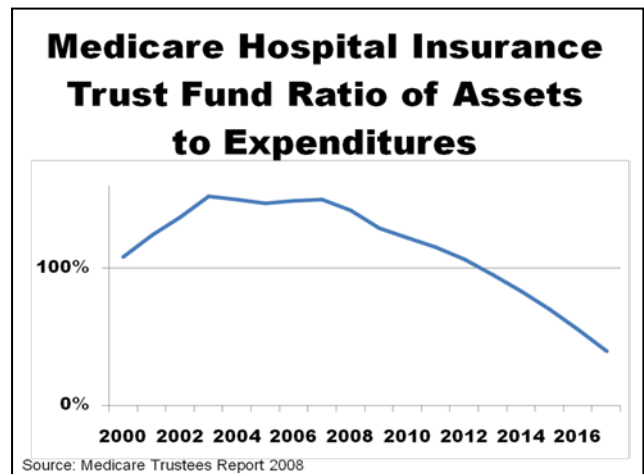
Health care expenditures have increased rapidly and there are no signs of the trend subsiding. The consumer price index increased by 57 percent from 1990 to 2006, while the medical care consumer price index surged 107 percent during the same period.¹⁹ Furthermore, national health expenditures have consumed an increasing share of the economy, accounting for 16 percent of GDP in 2006 compared to 12.3 percent in 1990.²⁰ By 2017, national health expenditures are expected to comprise 19.5 percent of GDP.²¹ If these trends continue, health care will account for an astonishing 48 percent of GDP in 2082.²²

The upward trend in health care expenditure affects Medicare as well. Medicare spending per enrollee increased at an average annual rate of 8.7 percent between 1970 and 2006.²³ Medicare spending growth has roughly paralleled that of private insurance on a per-enrollee basis. However, enrollment trends mean that aggregate spending will rise faster for Medicare. Between 2010 and 2017, as the first of the Baby Boomers enter the program, cumulative Medicare spending is projected to increase by 66 percent compared to a 50 percent increase in private insurance spending.²⁴



The aging and increased longevity of seniors add to Medicare's cost growth – but are not its major drivers. Aging accounts for about one-quarter of Congressional Budget Office projected Medicare and Medicaid spending growth through 2030.²⁵ Studies suggest that longer lives are not necessarily more expensive ones.²⁶ System-wide, high health spending per capita growth remains the problem.

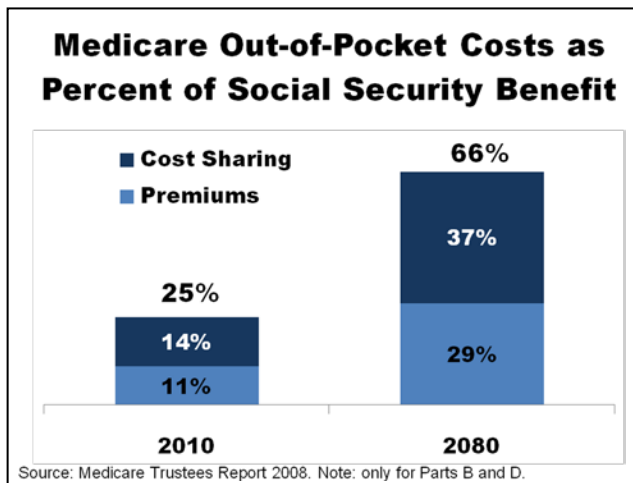
Medicare Cost Growth and the Budget. Since enactment, Medicare has claimed a progressively larger share of federal spending. In 1970, 3.4 percent of the federal outlays were dedicated to Medicare. This figure trebled to 14 percent by 2006.²⁷ Without mitigating action, Medicare is expected to encompass one-fifth of the federal expenditures in 2018.²⁸



Medicare's projected cost growth increases also strain its sources of financing. The Hospital Insurance component of the program has dedicated financing, primarily a payroll tax. Its assets are projected to be rapidly depleted in the next decade, and its trust fund is projected to be exhausted in 2019. The Supplemental Medical Insurance component of Medicare, that funds most outpatient services and prescription drugs, is financed through a combination of general revenue and beneficiary premiums. Growth of costs for these services has been around 10 percent per year. In addition, the difference between "dedicated" sources of revenue for Medicare (i.e., funding sources other than general revenue) and total outlays is projected to exceed 45 percent in 2014; this measure was recently created by congress to "trigger" action to address rising costs.²⁹

Medicare Cost Growth for Beneficiaries. Ballooning Medicare costs are also proving problematic for its beneficiaries. Median out-of-pocket expenditures for individuals over the age of 65 grew by 25 percent cumulatively between 1998 and 2002, and the proportion spending over a third of their income on health costs has climbed.³⁰

These recent increases in out-of-pocket spending have been particularly difficult for the Medicare population to absorb given its characteristics. In 2006, nearly half of the Medicare beneficiaries earned incomes below 200 percent of the poverty level. Medicare beneficiaries over 65 are more likely to be poor or near poor and spend a larger percentage of their income on out-of-pocket health costs, 12.5 percent compared to 2.2 percent for the under 65 population. The burden of increasing Medicare cost is magnified for racial minorities. More than 70 percent of African Americans and Hispanic beneficiaries have income below 200 percent poverty level, compared to 28 percent for white beneficiaries.³¹ Medicare beneficiaries with disabilities face particular challenges: not only are their health care costs higher than aged beneficiaries, but their ability to access supplemental insurance to mitigate them is lower.



The projected cost trends that have dire implications for the economy and the budget also pose major threats to Medicare beneficiaries. As out-of-pocket cost increase, beneficiaries will spend a greater percentage of their Social Security benefits on Medicare.³² The elderly will need a tremendous amount savings to supplement Medicare cost. On average, a couple (assuming a 82 and 85 year life expectancy for men and women, respectively) will need \$295,000 at the age of 65 to cover lifetime Medicare premiums and out-of-pocket expenses.³³ By 2030, the same study projects, the gap between expected retirement income and out-of-pocket health and long-term care spending may be \$400 billion. Thus, Medicare's projected spending could diminish affordable access to health care as well as retirement security.

Preserving Access

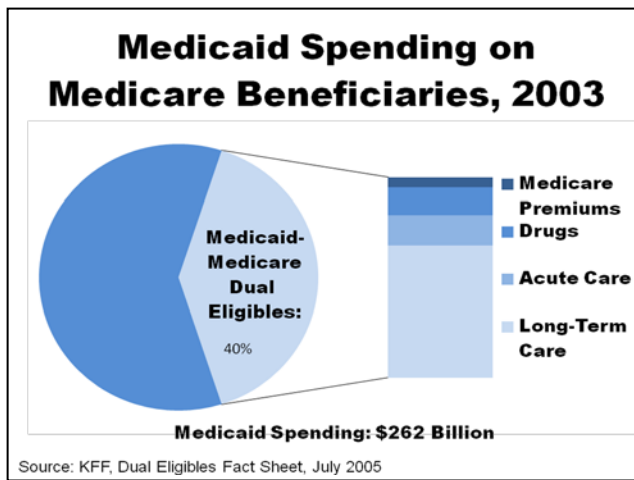
The inexorable cost trends will raise demand for supplemental coverage for Medicare as well as its costs. Currently, 90 percent of Medicare beneficiaries have supplemental coverage, mostly through former employers and individual-market policies called Medigap.³⁴ This insurance reduces Medicare's cost sharing and covers benefits outside of Medicare's scope. At the same time, it adds to the utilization and administrative costs of the system, and thwarts efforts to integrate care. Moreover, its future is uncertain.

Retiree Coverage is Eroding. Some large firms that historically offered health benefits to retirees face a different set of challenges today. Many can no longer afford to offer or sustain coverage of retired workers due to rising health care costs. In 1998, 66 percent of large firms offered retiree health benefits. By 2007, that figure dwindled to 33 percent.³⁵ Not only are fewer retirees covered, but those with coverage are paying more for their coverage and care. Firms that offer retiree benefits anticipate raising retiree contributions to premiums (64 percent); increasing cost-sharing requirements (26 percent); and raising out-of-pocket limits (18 percent).³⁶

Medicare Advantage's Future is Uncertain. A growing percent of Medicare beneficiaries are enrolling in private plans under Medicare Advantage as a way to access supplemental coverage. These plans are paid on a per-person basis, adjusted for the risk profile of enrollees. They offer Medicare benefits but are allowed to vary these benefits and offer additional ones to the extent that they can do so within their fixed payments. If they can offer Medicare benefits for below the fixed payment, they must share the savings with enrollees.³⁷

Due to policy, Medicare Advantage pays private plans, on average per person, 12 percent more than the traditional program. This has contributed to rapid rises in enrollment: from 13 percent of all beneficiaries in 2003 to 19 percent in 2007 – with projected enrollment of 26 percent in 2017.³⁸ However, Congress has contemplated ending overpayments to private plans. This could reduce projected enrollment from 14.1 to 6.1 million in 2017,³⁹ and limit its role as supplemental coverage.

Medicaid Will Be Strained. When Medicare was created, Medicaid assumed the role of paying for long-term care for low-income people. Over time, it took on the roll of paying Medicare's cost sharing for low-income beneficiaries. This roll has come at a considerable cost. Already, fully 40 percent of Medicaid spending is attributable to Medicare beneficiaries.⁴⁰ As the number and long-term care needs of Medicare beneficiaries expand with the demographic trends, so too will Medicaid and state costs. States finance, on average, 43 percent of Medicaid spending.



Promoting Value

Medical errors increased Medicare expenditures by \$8.8 billion, and were responsible for over 230,000 potentially preventable deaths between 2004 and 2006.⁴¹ The same study estimated that one in five Medicare patients that experience a patient-safety incident will die. Although measures are difficult to define, a plethora of studies suggest that beneficiaries receive low or decreasing quality of care. Quality problems could worsen with the increasing prevalence of chronic conditions.

Conclusion

The primary political reason for the urgency of Medicare reform is its projected cost growth. It will strain the budget, health system, and beneficiaries' income security. The gap in Medicare outlays and revenues will deteriorate at an alarming rate as the rise in life expectancy, the rise in chronic conditions, and the reduction in worker-retiree ratio exacerbate the situation.

Equally important are potential declines in the accessibility and quality of health care and coverage. Without changes to the Medicare and health system, many Medicare beneficiaries may not obtain necessary and high quality medical services.

However, Medicare has proven durable, with policy makers making the types of corrections and reforms needed to fulfill its mission. Moreover, Medicare's challenges are large, health system challenges. Policy makers across the political spectrum have placed a priority on health system reform, which could make a meaningful improvement in securing Medicare's future.

Acknowledgements

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¹⁴ 65+ in the United States: 2005; (U.S. Department of Health and Human Services and U.S. Department of Commerce); <http://www.census.gov/prod/2006pubs/p23-209.pdf> (April 17, 2008).

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