Center for American Progress

What's Driving up the Cost of Medicare?

Per Capita Costs Will Fall but the Number of Retiring Baby Boomers Will Not

Judy Feder and Nicole Cafarella June 2011

Introduction

Concerns about Medicare spending are front and center in discussions of how to rein in our federal budget deficit. That concern is understandable given Medicare's share of the federal budget—at 12 percent and growing.[1] At the same time, Medicare's trustees predict that Medicare's Part A trust fund, which pays primarily for hospital care, will become insolvent—with revenues insufficient to pay full benefit—by 2024.[2]

Whether from a fiscal or a solvency perspective, then, these projections raise real challenges for sustaining the Medicare program. Today 48.5 million people rely on Medicare to make quality health care affordable. In 2035, when Medicare has absorbed the baby boom generation, beneficiaries of the program will number 85.3 million.

Serious proposals to address these challenges can only be based on a clear understanding of the underlying facts about what is driving Medicare's cost growth. The two most salient facts are these:

- The payment changes in the Affordable Care Act enacted last year actually do "bend the cost curve" by bringing the projected growth in Medicare spending per beneficiary well below projected per capita growth in health care spending overall.

- Medicare spending is not just about costs per beneficiary but also about the number of beneficiaries—and this year is when the baby boom generation begins to turn age 65 and becomes eligible for Medicare, adding a million and a half more beneficiaries to Medicare's rolls every year.[3]

This means the Medicare program will be doing its part to become more effective and efficient in "per capita" spending, controlling the cost of health care while improving the quality of care, but more revenues will be needed to support the growing numbers of older Americans who are aging into the Medicare program.

Medicare can continue to slow its spending growth through the payment reforms required by the Affordable Care Act. But to achieve a sustainable slowdown will require that all payers—private as well as public—commit to efficiency in health care across the board. This issue brief will demonstrate why extending Medicare's effectiveness in containing costs to the private sector, not turning Medicare into private insurance, is the right way to rein in our nation's health care costs and to reduce the federal budget deficit.

Medicare spending is the product of two components: the dollars spent on each beneficiary and the number of beneficiaries. This decade marks a change in the relative role each plays in driving growth in Medicare spending. So let's look at each aspect of Medicare spending in turn.

The Affordable Care Act significantly slowed per beneficiary spending growth

Although Medicare spending per enrollee has grown more slowly than private health care spending for most of its history,[4] health care spending in general and Medicare in particular have grown faster than the economy. But provisions in the Affordable Care Act to reduce growth in payments to providers such as hospitals, skilled nursing facilities, and home health agencies mean that growth in Medicare per beneficiary spending will fall well below overall growth in health spending per person and well below growth in the economy.

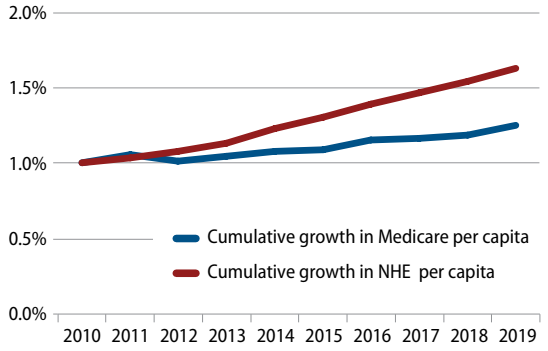
From now until 2019, the last year for which total spending data are available, overall health spending per person is expected to increase at an average annual rate of 5.6 percent. Medicare spending will grow 3 percentage points slower.[5] (see Figure 1)

More remarkably, Medicare's per beneficiary spending growth of 2.8 percent from 2010 to 2021 is expected to be a full percentage point below growth in per capita gross domestic product, the broadest measure of products and services in our economy.[6] That's a dramatic turnabout from the previous decade. From 2001 to 2010, Medicare per capita spending grew an average of 6.8 percent, or 3.7 percentage points faster than per capita GDP.[7] (see Figure 2)

FIGURE 1

The Affordable Care Act bends the cost curve

Cumulative growth in Medicare versus national health expenditures per capita, 2010–2019

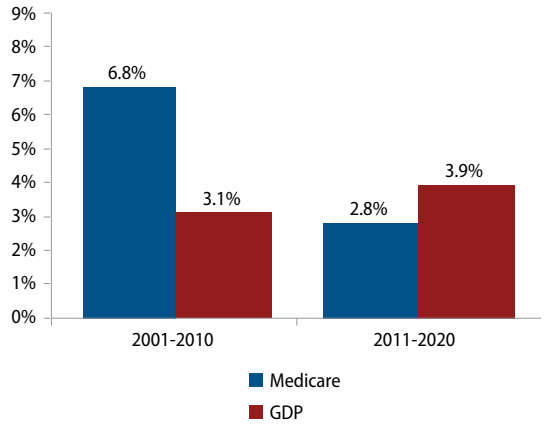


Sources: Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds, "2011 Annual Report of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds" (2011), available at http://www.cms.gov/ReportsTrustFunds/downloads/tr2011.pdf; "State Interim Population Projections by Age and Sex: 2004 - 2030," available at http://www.census.gov/population/www/projections/index.html; Centers for Medicare and Medicaid Services, "National Health Expenditures Projections 2009-2019" (2010), available at http://www.cms.gov/NationalHealthExpendData/downloads/NHEProjections2009to2019.pdf.

FIGURE 2

Affordable Care Act slows health care spending below the growth of our economy

Average annual per capita growth for Medicare and for gross domestic product



Sources: Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds, "2011 Annual Report of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds" (2011), available at http://www.cms.gov/ReportsTrustFunds/downloads/tr2011.pdf; "Table 1. Annual Estimates of the Resident Population for the United States, Regions, States, and Puerto Rico: April 1, 2000 to July 1, 2009," available at http://www.census.gov/popest/states/NST-ann-est.html; "State Interim Population Projections by Age and Sex: 2004 - 2030," available at http://www.census.gov/population/www/projections/index.html; Congressional Budget Office, "The Budget and Economic Outlook: An Update" (2010), available at http://www.cbo.gov/ftpdocs/117xx/doc11705/08-18-Update.pdf.

The baby boom generation increases enrollment

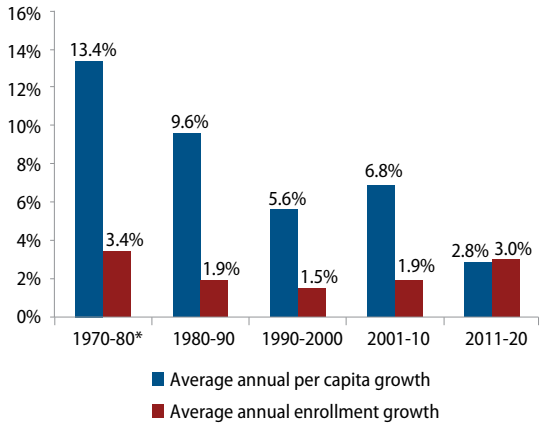
At the same time this slowdown occurs, however, the number of enrollees in Medicare begins to rise. The first of the baby boomers become eligible for Medicare in 2011. In contrast to enrollment growth from 2001–2010 (average annual growth in beneficiaries was 1.9 percent or half a million to a million more people each year), enrollment from 2011–2020 is projected to grow by an average of 3 percent per year, or a million and a half more people each year.[8]

What does this mean for overall spending growth? For the first time in Medicare's history, growth in the number of Medicare beneficiaries has become a major factor in driving growth in total Medicare spending. In the 1970s, average annual enrollment growth was 3.4 percent while average annual per capita growth was four times greater (13.4 percent). That was the only decade in which Medicare eligibility was expanded (to include people with disabilities). From 1980 through 2010, average annual enrollment grew at a steady rate just below 2 percent; average annual per capita spending grew four to five times faster.

FIGURE 3

The changing reasons for rising Medicare costs

Per capita Medicare spending and Medicare enrollment growth, 1970–2020



*In 1972, Medicare was expanded to cover disabled social security beneficiaries.

Source: Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds, "2011 Annual Report of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds" (2011), available at http://www.cms.gov/ReportsTrustFunds/downloads/tr2011.pdf.

In every decade prior to the one coming up, growth in spending per capita has been the predominant factor in determining how fast overall Medicare spending grows—ranging from four to five times the rate of growth in beneficiaries. In the coming decade, with the baby boomers on the rolls, for the first time the two components will be equal. (see Figure 3)

The bottom line

Over the next two decades, Medicare will welcome the baby boomers born between 1946 and 1964 onto its rolls as they turn age 65. By 2035, 20 percent of the U.S. population will be aged 65 or over, up from 13 percent today.[9] Starting in 2011, Medicare enrollment will increase by a million and a half people every year.[10] Even with efficiencies that slow Medicare cost growth, taking care of a substantially larger older population will simply require spending more.

Recognizing the demographic facts doesn't obviate Medicare's need to spend federal health care dollars effectively and efficiently to slow the growth of health care costs while improving the quality of care for each and every beneficiary. But arguments that efficiency will come from morphing Medicare into a private insurance market—the conservative "solution" to rising health care costs—make no sense. There is simply no evidence that a private marketplace can match Medicare's ability to slow spending growth.[11] With Medicare's per capita cost growth already lower than GDP and projected to diverge increasingly from private health care spending, vouchers for private insurance would actually increase per capita costs.[12]

What does make sense to achieve further per capita spending reduction is to align the private sector with the public sector's commitment to health care payment reform. The Affordable Care Act requires Medicare to find ways to reward better, not just cheaper, care. To make sure that happens, the law sets an annual target for Medicare per capita spending growth and triggers Medicare payment changes if spending projections indicate the target will be breached. To slow the per capita growth rate systemwide, policymakers should enact legislation that modifies the target to apply beyond Medicare to private insurance spending and to trigger all-payer payment reform if the target is breached.

Understanding what's driving Medicare costs makes it clear that Medicare is doing its part to slow growth in spending per beneficiary as the number of beneficiaries begins to increase. But Medicare's payments can deviate only so far from private insurers' payments before health care providers start avoiding Medicare patients or demanding that private insurers make up for Medicare's low rates. The upshot: Measures to further constrain Medicare per capita spending without regard to overall health spending are misguided.

What's needed are measures to assure that all payers—private and public—are partners in payment reform—or legislation that sets limits on systemwide health spending and holds all payers accountable for payment reforms to achieve it. Only a systemwide partnership can effectively slow spending and secure coverage at the same time.

Building an effective partnership between public and private payers to slow the cost of health care across the economy—not just in Medicare—will take time. But Medicare beneficiaries can't wait, and the Medicare trust fund is exhausted in 2024. Arguments that individual retirees themselves can finance the extra spending through Medicare vouchers or other means ignores fundamental realities, among them:

- Medicare benefits are not generous.
- Beneficiaries already pay substantial sums (and shares of income) out of pocket
- Medicare premiums are already means-tested, with higher-income beneficiaries required to contribute more.

Greater efficiency in per beneficiary spending by the Medicare program will go a long way to ease the burden of paying for a growing elderly population. And bringing private payers into the cost-control system set up by the Affordable Care Act for Medicare will definitely take time and effort. So in the meantime—amid today's debate in Washington about how to rein in the federal budget deficit—policymakers simply have to recognize that Medicare will need more federal revenues to get all the way there.[13]

This is a small price to pay for living up to the nation's commitment to assuring affordable health care to the nation's seniors.

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Endnotes

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13 Judy Feder and Marilyn Moon, "Proceed with Caution: Renewed Calls to End Medicare as We Know It Because We Can't Afford It Misunderstands the Facts" (Washington: Center for American Progress, 2011), available at http://www.americanprogress.org/issues/2011/05/medicare_works.html.