Insight on the Issues

Medicare Financial Outlook: What Do Trust Fund Solvency Projections Mean?

Harriet Komisar
AARP Public Policy Institute

Nearly all Americans ages 65 and older, plus millions of younger people with long-term disabilities, rely on the Medicare program for health insurance. While Medicare trust fund estimates show that Medicare faces some financial challenges, the program is not “going broke” and does not need drastic changes to remain strong. As in the past, incremental adjustments can strengthen Medicare’s trust fund solvency and enable the program to continue protecting the people who rely on it today and in the future.

INTRODUCTION

Medicare is a nationwide, federal program providing health insurance coverage for nearly all Americans ages 65 and older and some people younger than age 65 with long-term disabilities. In 2019, Medicare covered 61 million people, or about 19 percent of the US population.¹

Every year the Medicare Trustees update projections of the program’s future spending and revenues. The most recent Trustees Report, issued in April 2020, estimates the Hospital Insurance (also called Part A) trust fund, which pays for about 40 percent of Medicare services, will become insolvent in 2026—six years away at the time of the report’s release.² That projection is consistent with the Trustees’ two previous reports, published in 2019 and 2018, which also projected trust fund insolvency in 2026.³ The estimates in the 2020 Trustees Report do not take into account the effects of the COVID-19 pandemic. This Insight on the Issues examines what the Trustees’ projections for the Part A trust fund mean and the level of concern this should raise. As it turns out, claims that Medicare is running out of money are greatly exaggerated. While incremental policy changes can strengthen the program’s financial health—as they have many times in the past—Medicare is not going bankrupt and does not need drastic changes.

MEDICARE SOLVENCY: WHAT IT ACTUALLY MEANS

Medicare solvency refers to whether Medicare will have enough financial resources to pay for benefits in the future. Claims that Medicare is in danger of “going broke” refer to the Medicare Hospital Insurance (or Part A) trust fund. Medicare’s
spending for inpatient hospital stays, skilled nursing facility care, and some home health care are paid out of the Part A trust fund.

Revenue flows into the Part A trust fund each year. Revenues consist mainly of those coming from the Medicare payroll tax paid by workers and their employers. In years when revenue exceeds spending, assets build up in the trust fund, and those assets can then be drawn down in years when revenue falls short of spending. Given the way Part A financing is designed, it is possible that the trust fund’s combined current revenue and accumulated assets might, at some time, not be enough to pay for all the current Part A expenses—a situation referred to as trust fund insolvency or depletion.

The Difference between Trust Fund Insolvency and Running Out of Money
This is where confusion often arises. Insolvency simply means that Medicare would fall short of being able to fully pay for the services covered by Part A—it does not mean Medicare would be out of money. The revenues that flow into the trust fund would cover the lion’s share of Part A expenses. In 2026, the trust fund’s revenues would still cover an estimated 90 percent of Part A expenses.

Further, the Part A trust fund pays for just one part of the larger Medicare program. Medicare Part B covers physician and outpatient services and Part D covers prescription drugs. Parts B and D are always fully funded by a combination of sources consisting mainly of general revenues and premiums paid by people with Medicare (see box).

In 2019, Part A constituted 41 percent of total Medicare spending. In 2026, it is projected to be slightly lower, at 39 percent. Thus, even if the trust fund were able to cover only 90 percent of Part A expenses in 2026, as currently projected, Medicare as a whole would be able to cover about 96 percent of total program costs that year.

Looking further ahead, the Trustees project that the percentage of Part A costs covered by revenue will decline from 90 percent in 2026 to a low of 78 percent in 2044 and then increase to about 90 percent by the end of the Trustees’ long-range (75-year) projection period. Even if this occurred, Medicare as a whole would continue to be able to cover more than 90 percent of its expenses—the estimated low is about 92 percent in 2044—throughout the long-range projection period.

The law governing Medicare does not specify what exactly would happen if the trust fund ever became insolvent. Under current law, if this were to happen, Medicare could only pay what it owed to hospitals and other providers for Part A services to the extent it had the money available from Part A revenue. Therefore, provider payments would likely be affected. For people covered by Medicare, their Medicare benefits and costs would not be affected.

The Uncertainty of Trust Fund Projections
Another important qualifier to keep in mind about the Trustees’ estimates is that they are based on current law and on “intermediate” assumptions about future economic activity, demographic characteristics, and use of medical services. As the Trustees point out, actual circumstances in the future may differ from the intermediate assumptions. To illustrate the potential effects of this uncertainty, the 2020 Medicare Trustees Report also includes projections based on alternative, plausible assumptions. Using these alternative assumptions, Part A trust fund projections range from insolvency as soon as 2023 to insolvency never occurring within the 75-year projection horizon.

The uncertainty is amplified by the COVID-19 pandemic. The potential effects of the pandemic are not included in the intermediate or alternative assumptions analyzed in the 2020 Trustees Report. In the report, the Trustees concluded that it was not possible to accurately include the effects of the pandemic at the time of the report, given the uncertainty about what those effects may be. Generally, however, the pandemic is expected to affect both the revenues and the expenditures of the Part A trust fund. Higher unemployment and slowing of the economy are likely to mean lower payroll tax revenues flowing into the Part A trust fund. The direction of the overall effect on Part A spending is unclear. While there will be greater spending for services related to COVID-19, there will likely be less use of some other services than had been expected as some tests, surgeries, and other
HOW IS MEDICARE FINANCED?

Medicare is financed with a combination of revenue from different sources. These consist mainly of general tax revenue (43% in 2019), payroll taxes paid by workers and employers (36%), and premiums paid by people enrolled in Medicare (15%; see figure 1). The various parts of Medicare differ, however, in their financing structures. Part A (which covers inpatient hospital care, skilled nursing facility services, and some home health care) is financed primarily with payroll taxes paid by workers and employers. Individuals pay these taxes during their working years. In return, they are eligible to enroll in Part A at age 65 (or earlier if they qualify on the basis of disability) and do not pay a premium for Part A coverage. Some people who do not have the qualifying amount of payroll tax history instead pay Part A premiums.

Part B (which pays for physician, outpatient, and some other services) and Part D (which covers prescription drugs) use a different financing structure. These two parts are funded primarily by general revenue and premiums paid by individuals (or by states on behalf of eligible individuals with low incomes). In 2019, premiums represented 27 percent of Part B revenue and 16 percent of Part D revenue. Part C of Medicare, also known as the Medicare Advantage program, is financed using revenues from the other parts of the program.

FIGURE 1
Sources of Medicare Revenue, 2019


Notes: “Other” includes transfers from states (for Part D), taxation of Social Security benefits (for Part A), interest, and other sources. General revenue is less than 1 percent of Part A revenue.
services are delayed or skipped. It is also unclear how short or long a period of time the effects on trust fund revenues and Medicare spending may last.

Further compounding the uncertainty are factors that may slow spending growth. The Medicare program is in the midst of considerable innovation, making it especially difficult to project future spending. Over the past several years, the Medicare program has been developing and testing new payment and delivery models designed to improve value and reduce spending. Those innovations could be expanded or new, yet-to-be conceived innovations could be developed, in both cases resulting in lower spending. Solvency projections do not take into account such possible advances.

A HALF-CENTURY OF SOLVENCY: A HISTORICAL PERSPECTIVE

Another means of understanding Medicare’s financial health is to consider the program’s history. Medicare has faced projections of insolvency for the Hospital Insurance trust fund since it began, but it has always remained solvent. Between 1970 and 2020, the projected time to insolvency has ranged from 2 years (in 1970 and 1971) to 28 years (in 2001 and 2002; see figure 2). In fact, since 1970, the Trustees have projected insolvency within 6 years—that is, the number of years projected in the most recent report for insolvency to occur—8 times, and have projected insolvency within 10 years a total of 19 times.

The trust fund’s outlook has changed over time as the result of factors unrelated to Medicare policy, such as changes in economic conditions, as well as changes in Medicare’s policies.

Trust Fund Impacts: Economic Conditions and Other Non-Medicare Factors

Unrelated to Medicare, the status of the overall economy—in particular, economic recessions and recoveries—has a substantial effect on trust fund projections because the economy affects

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FIGURE 2

Projected Number of Years until Medicare Hospital Insurance Trust Fund Insolvency


Note: Specific estimates were not provided in 1973-1977 and 1989.
the Medicare payroll tax collected, which is the main revenue source for the Part A trust fund. For example, in the late 1990s and early 2000s economic conditions were better than had been anticipated, so the Trustees increased their estimate of the time until insolvency. Going in the other direction, because of recessions in the early 1990s and in 2009 the Trustees lowered their estimates of trust fund revenue from the Medicare payroll tax, which shortened the estimated time to insolvency.

Similarly, in their 2018 report the Trustees projected insolvency would occur three years earlier than they had projected the previous year, mainly because of a reduced estimate of the income going into the trust fund. One reason expected revenue went down was that economic conditions were lower than previously forecast, which reduced expected revenue from the payroll tax. In addition, trust fund revenue projections also decreased because of changes in tax policy; specifically, legislation in 2017 that lowered taxes led to the government collecting less revenue from taxes on Social Security benefits, a portion of which goes into the Part A trust fund. One reason expected revenue went down was that economic conditions were lower than previously forecast, which reduced expected revenue from the payroll tax. In addition, trust fund revenue projections also decreased because of changes in tax policy; specifically, legislation in 2017 that lowered taxes led to the government collecting less revenue from taxes on Social Security benefits, a portion of which goes into the Part A trust fund.15

Trust Fund Impacts: A Variety of Medicare Policy Changes
Over Medicare’s history, Congress has enacted numerous policy changes that have affected the trust fund—many extended its solvency while others shortened it. Numerous changes have improved trust fund solvency by lowering Medicare’s spending compared with previous projections. Others have repeatedly extended the trust fund’s solvency by expanding the trust fund’s revenue. If needed, policy makers could again use policy changes like these to address solvency challenges.

Laws affecting Medicare typically include several policy modifications implemented together, so changes over time in trust fund projections reflect a combination of Medicare policies (as well as changes not related to Medicare, as described above). Past experience shows combinations of incremental policy modifications can have a substantial effect on improving trust fund solvency. For example, the Balanced Budget Act of 1997 reduced spending growth by decreasing the annual updates to hospital payments, modifying payment methods for home health care and skilled nursing facilities, and shifting some home health spending from Part A to Part B. In addition, the act increased trust fund income from payroll taxes. In 1998, the Medicare Trustees Report projected insolvency to occur in 10 years, up from their projection of only 4 years in the prior year’s report.16

As another example, in 2010 the Trustees increased the estimated solvency period by 12 years, reflecting numerous changes enacted in the 2010 Affordable Care Act. These changes lowered spending for hospitals and other Part A services and increased trust fund revenue by establishing a higher payroll tax on earnings over a specified amount, beginning in 2013.17

Policy Changes That Slowed Spending Growth
In general, Congress has used four broad approaches to slow growth in spending for inpatient hospital care and other Part A services:

- **Adopting new payment methods to create incentives for efficiency and lower spending.** A notable example is when, in the mid-1980s, Congress adopted the prospective payment system for inpatient hospital services. Under this approach, Medicare pays hospitals a single payment for each hospital stay, based on the patient’s diagnosis (specifically, diagnosis-related group), instead of paying separately for each specific service. The shift in payment methods gave hospitals an incentive to provide care more efficiently and shorten hospital stays, which slowed spending for hospital care significantly and extended trust fund solvency projections. As another example, in 1997, Congress adopted new payment systems for home health care and skilled nursing facility services, the other major services covered by Part A, which also led to lowered spending.

- **Reducing updates in payment rates compared with current law.** Congress has frequently reduced annual updates in fees paid to hospitals, skilled nursing facilities, and home health agencies, often as part of large budget reconciliation laws.18 These policies have contributed to reductions in spending growth and, combined with other
changes, extended the solvency period for the Part A trust fund numerous times.

• **Shifting some services from Part A to Part B.** In particular, a portion of home health care benefits were shifted from Part A to Part B, beginning in 1998, by the Balance Budget Act of 1997. Prior to this change, all home health benefits were covered under Part A.

• **Developing new payment methods designed to promote more-coordinated care, reduce Medicare spending, and enhance value.** The Affordable Care Act required some new models to be tested; it also established the Center for Medicare & Medicaid Innovation to develop and test additional models.\(^\text{19}\) The Trustees’ projections reflect the effects of changes in payment and delivery methods that have already occurred but they do not estimate potential future effects.\(^\text{20}\)

**Policy Changes That Increased Trust Fund Revenue**

Since the earliest years of the program, Congress has acted many times to increase revenues into the Part A trust fund, both by modifying the payroll tax and by adding another dedicated source of income to trust fund revenues.\(^\text{21}\) Modifications over time include the following:

• **Raising the payroll tax rate.** During the first 20 years of the Medicare program, Congress periodically increased the payroll tax rate. The most recent increase was in 1986 to its current level of 1.45 percent each for workers and employers, from 1.35 percent each in 1985.

• **Raising, and then eliminating, the limit on earnings subject to the payroll tax.** Initially, the Medicare payroll tax applied only to earnings up to a specified maximum amount. That cap increased, usually annually, until it was removed in 1994. For example, in 1993, the last year with a cap, the payroll tax applied to a maximum of $135,000 in a worker’s yearly earnings.

• **Increasing the payroll tax for people with higher incomes.** As of 2013, workers pay an additional Medicare tax of 0.9 percent on earnings over $200,000 per year for individuals ($250,000 for couples).

• **Establishing an additional source of revenue for the trust fund.** As of 1994, a portion of the federal income taxes paid on Social Security benefits goes into the Part A trust fund.\(^\text{22}\)

**FUTURE OUTLOOK: CONTINUED ATTENTION, CONTINUED SOLVENCY**

As in the past, the trust fund solvency projections will continue to vary from year to year with changes in economic forecasts and expectations about patterns of Medicare service use and spending. Especially important are forecasts of inpatient hospital services, since they constitute most of Part A spending.

With changes already under way in the Medicare program—in particular, the testing and adoption of payment innovations and person-centered care, which are reducing unnecessary spending and slowing spending growth—actual spending may turn out to be lower than the Trustees’ current projections and, thus, the solvency outlook may improve. Still, policy changes may be needed to strengthen the Part A trust fund in the future.

Similar to the past, a wide variety of incremental changes in Medicare policy could extend the trust fund’s solvency. As the historic record shows, relatively small payment modifications that slow spending growth can have a significant positive impact on the trust fund. Policies to increase trust fund revenue are also possible and have been adopted numerous times throughout Medicare’s history. As has always been the case, sustaining Medicare for the future will require continued attention to improvements and incremental adjustments, not drastic change.

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2 2020 Medicare Trustees Report.


5 In this report, “trust fund” refers to the Hospital Insurance trust fund. Medicare also has a second trust fund, called the Supplementary Medical Insurance trust fund, which pays for Part B (physician and other outpatient services) and Part D (prescription drugs). Potential insolvency is not a concern for the Supplementary Medical Insurance trust fund.

6 2020 Medicare Trustees Report.

7 Author’s calculations based on data from 2020 Medicare Trustees Report, table II.E1 and table V.B1.

8 2020 Medicare Trustees Report, 27.


10 Davis, Medicare.


12 2020 Medicare Trustees Report, 1.


15 Davis, Medicare.


18 Davis, Medicare.


20 2020 Medicare Trustees Report.

21 Davis, Medicare.

22 2019 Medicare Trustees Report.