Paying for the Looming Medicare Expenditures: Options for the New Administration

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Some Startling Forecasts
Medicare Funding Shortfalls as a Percent of Federal Income Taxes

Trustees and CBO

Source: 2008 Medicare Trustees Report, CBO “The Long-Term Outlook for Health Care Spending,” Nov. 2007 and author’s estimates. Federal Income Taxes are estimated to be 10.7% of GDP, the 50-year average.

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Social Security and Medicare Funding Shortfalls as a Percent of Federal Income Taxes

Source: 2008 Social Security and Medicare Trustees Reports, “The Long-Term Outlook for Health Care Spending,” Congressional Budget Office, Nov. 2007 and author’s estimates. Federal Income Taxes are estimated to be 10.7% of GDP, the 50-year average.

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Federal Government Share of GDP

Non-Entitlement Expenditures Remain at Current GDP Share

Past Federal Government GDP Share

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Medicare’s 75-Year Obligations
in Excess of Current Transfer Share of GDP

Trillions (2007)

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<th>Trustees Medicare</th>
<th>CBO Medicare</th>
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Medicare’s Long-Run Obligations in Excess of Current Transfer Share of GDP
Congressional Budget Office Projections Extended by Assuming Medicare Growth rate Equals GDP
Growth Rate After 2082
The Cost of Doing Nothing
Let The Workers Pay
The Payroll Tax Required to Pay for Projected Medicare and Social Security Deficits While Maintaining Non-Entitlement Expenditure Share of GDP

2008 Trustees Report Base

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Let the Elderly Pay
Medicare Premiums if Premiums Cover Medicare Deficits
Monthly $2008

Constant Transfer Share From Non-Entitlement Federal Revenues
2008 Trustees Report Base

2005 $122.00
2015 $405.88
2025 $842.57
2035 $1,423.84
2045 $1,603.92
2050 $2,137.10
2055 $1,202.99
2060 $1,603.92
2075 $3,176.99

CBO

$5,626.06

Trustees

$3,176.99

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Medicare Premiums as a Share of Projected Medium Earner Social Security Benefits

Medicare Transfer is a Constant Share of Federal Non-Entitlement Revenues
Part A Payroll Taxes Remain at Current Level
2008 Trustees Report Base

Transfer fixed 2008 share of GDP from Table III.A2 2008 Medicare Trustees Report.
Let Workers and the Elderly Share the Burden
Medicare Premiums if Payroll Taxation Balances the Medicare Part A Budget
Monthly $2008

Constant Transfer Share From Non-Entitlement Federal Revenues
2008 Trustees Report Base

2020 $122.00
2025 $292.51
2030 $560.99
2040 $879.75
2045 $1,276.68
2050 $979.75
2075 $3,232.09

CBO

2020 $1,276.68
2040 $979.75
2050 $1,868.28

Trustees

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Premiums as a Share of Projected Medium Earner Social Security Benefits

Constant Transfer Share of Federal Non-Entitlement Revenues to Parts B and D
Part A Payroll Taxes Balance the Medicare Part A Budget
2008 Trustees Report Base

Transfer fixed at 2008 share of GDP from Table III.A2 2008 Medicare Trustees Report.

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What Can Reform Accomplish?
Benefit Cut Reforms
The Usual Reforms

- The Bipartisan Commission on Medicare
  - Raise Age of Eligibility to match Social Security
- Fixing Benefits at Retirement
  - As of the date of your retirement
- No First Dollar Coverage
  - $5,000 deductible
  - No Medi-gap
- Means Testing
  - Those below or near poverty pay nothing
  - Above the minimum threshold, benefits fall until they reach only 20% of current levels
Required Transfers with Three Reforms: Commission, Retirement Technology, and 2011 Technology Medicare

% Non-Entitlement Federal Revenues

Non-entitlement Federal Taxes are estimated to be 11.80% of GDP, the 25-year average. Assumes no change in projected total spending.

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Required Transfers with Two Reforms:
Means-Tested and No First-Dollar Coverage Medicare

% Non-Entitlement Federal Revenues

Non-entitlement Federal Taxes are estimated to be 11.80% of GDP, the 25-year average. Assumes no change in projected total spending.

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Percent Reduction in Projected Medicare Expenditures
After 75 Years

Note: Restricted to beneficiaries 65 and older.
The Source of the Problem?
Personal Health Care Spending by Source of Funds

- Public
- Private
- Out-of-pocket
- Other private

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Cosmetic Surgery and General Health Care Inflation

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The Real Answer

Prepaying Retirement Consumption
of Both Goods and Health Care
Through Private Accounts
Details

- Workers contribute a fixed percentage of their total wage income to a Health Insurance Retirement Account (HIRA) during their working lives.
- When they enroll in Medicare at age 65, beneficiaries will use their HIRA balances to purchase an annuity paying an annual fixed sum to a spending account, such as a Roth Health Savings Account (HSA).
- Accounts are not heritable.
- Beneficiaries will use their HIRA annuities to pay for a share of their Medicare costs and any funds remaining at the end of the year can be withdrawn tax free and spent on nonmedical goods and services.
Current and Reformed Medicare Spending as a Percentage of GDP, Including Capacity Supply Side Responses

Estimation parameters: Contribution rate 4%, accumulation and decumulation real return 5.2% and 2.9%, respectively, base deductible in 2007 $2,500.
The Bottom Line

• Fundamental reform with prepayment can revitalize Medicare while reducing government debt.
• Over the short term, reform is not free.
• Over the long term, reform can reduce taxes and restore Medicare to a sound fiscal position.
• Reform will eventually benefit recipients and workers alike by bestowing real ownership of retirement benefits.
The Diagnosis and Treatment of Medicare

"It is the most readable, most lucid, most comprehensible book on Medicare issues that I have ever read. It is a must read for anyone concerned about the future of Medicare." —David R. Keck, Senior Fellow, Manhattan Institute

"This is by far the most comprehensive and compelling analysis produced to date of the long-term fiscal challenges posed by Medicare. The authors present their case with clarity, precision, and a sense of responsibility. They make a strong case for fundamental reform of Medicare and also demonstrate that the current system is underfunded, the long-term problems will become even more serious, and the public will have to make tough choices in the years ahead." —Thomas R. Saving, Senior Fellow, American Enterprise Institute

"This book is a must read for anyone concerned about the future of Medicare. It presents a clear, concise, and compelling argument for reform. The authors provide a comprehensive and well-reasoned analysis of the issues facing Medicare and offer a practical and realistic plan for reforming the program." —Jagadeesh Gokhale, Senior Fellow, Cato Institute

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