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Medicare Cuts: Why?

by John S. Hoff

Medicare will be at the core of the debate over the Republicans' proposal to both balance the federal budget by 2002 *and* make substantial tax cuts. The most heated controversy will be whether Medicare must be cut (i.e., the rate of increase reduced) in order to save it (as the Republicans say) or whether it is being cut (so defined) in order to finance the tax cuts (as the Democrats will charge).

Which is it?

Interestingly, the answer is a mixture of both.

As of late this summer, the Senate budget resolution reduces Medicare by $256 billion over seven years (and reduces Medicaid by $176 billion over that period). The House is slightly more stringent. It reduces Medicare expenditures by $288 billion in the same period (and Medicaid by $187 billion). Medicare and Medicaid together are more than one-third of the total cuts contemplated in the two budget resolutions.

The trustees of the Hospital Insurance Trust Fund (Part A) recently released their report on the financial status of the Trust Fund. On the basis of intermediate assumptions (which many believe to be optimistic), they project that the Trust Fund will be depleted in 2002. Part A is now spending more than is raised by the payroll taxes that finance it. It will be in the black this year only because of interest earned on the Trust Fund balance ($133 billion at the end of 1994). Next year, however, even with interest, expenditures are projected to surpass income by $900 million. The shortfall will accelerate in the next few years, and the Trust Fund will be exhausted by 2002.

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This is just the beginning of the problem. If Part A could spend money after the Trust Fund is depleted, its expenditures would exceed revenues by $1.171 trillion in 2030, and $2.345 trillion in 2040. These are yearly results, not the cumulative deficit. These figures were developed by Peter Peterson and published as a supplement to the report of the Kerry-Danforth Commission on Entitlements.

These deficits cannot happen under current law. HCFA is not authorized to make payments under Part A when there is no money in the Trust Fund from which the payments can be made. However, the deficits are a measure of the gap between what has been promised to Medicare beneficiaries and what revenues will be available to pay for it. To save the Trust Fund, expenses must be brought in line with revenues, payroll taxes must be increased, *or* the law must be changed to provide for financing Part A through general revenues (i.e., an increase in the income tax).

Consequently, if payroll or income taxes are not increased, the only way to save Part A as an ongoing program is to reduce expenditures. Hence, it is true that Medicare Part A must be "cut" in order to be saved.

Part B presents a different picture. Twenty-five percent of the cost of Part B is financed by premiums paid by beneficiaries. The other 75 percent comes from general tax revenues. Medicare Part B has an entitlement draw on government funds. There is no mechanism in Part B for limiting expenditures as there is in Part A.

In 1995 the government will spend $46 billion as its share of the Part B costs. Part B expenditures are projected to rise even more rapidly than Part A. In 2002 the government's expenditures for Part B services are expected to be $117 billion, or $71 billion more than it will spend in 1995. The cumulative increase in government expenditures in the period 1995-2002 over 1995 is more than $260 billion. By operation of current law, this is an amount that must be paid, either through increased income taxes or through borrowings and a larger federal budget deficit.

A "cut" in Part B expenditures, therefore, will reduce what would otherwise be an increase in income taxes or in the deficit. On the other hand, it can be viewed in just the opposite way. The projected budget deficit in 2002 under current law is $284 billion. The increase in the government's contribution to Medicare Part B in that year over its current costs is $71 billion in 2002, which is 25 percent of that year's deficit. Is reducing Part B expenditures an effort to balance the budget or raise taxes at the expense of Medicare beneficiaries or is it necessary to prevent Medicare from adding to the deficit? It all depends on how one looks at it.

Because there is some element of truth on all sides, the debate on why Medicare is being "cut" will be particularly heated and confused.