Medicare: The Basics
Financing and Payments

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Medicare Financing

- Part A—Hospital Insurance (HI) Trust Fund
  - Payroll Tax---2.9% of earnings
    (½ Employee ½ Employer)
  - Interest on Trust Fund balances and tax on Soc. Sec. payments

- Part B—Supplementary Medical Insurance (SMI)
  - General Revenues ≈ 75 Percent
  - Beneficiary Premiums ≈ 25 Percent
    - $78.20 per month (2005); $89.20 per month (2006)
    - Income related beginning 2007 for beneficiaries with AGI ≥ $80,000

Medicare Financing

- Part D
  - Federal General Revenues ≈78 percent
  - State Payments ≈11 percent
  - Beneficiary Premium ≈10 percent
    - Actual premium depends on choice of plan
    - Equals 25.5 percent of the standard drug benefit
    - Estimated monthly average nationally is $37.23

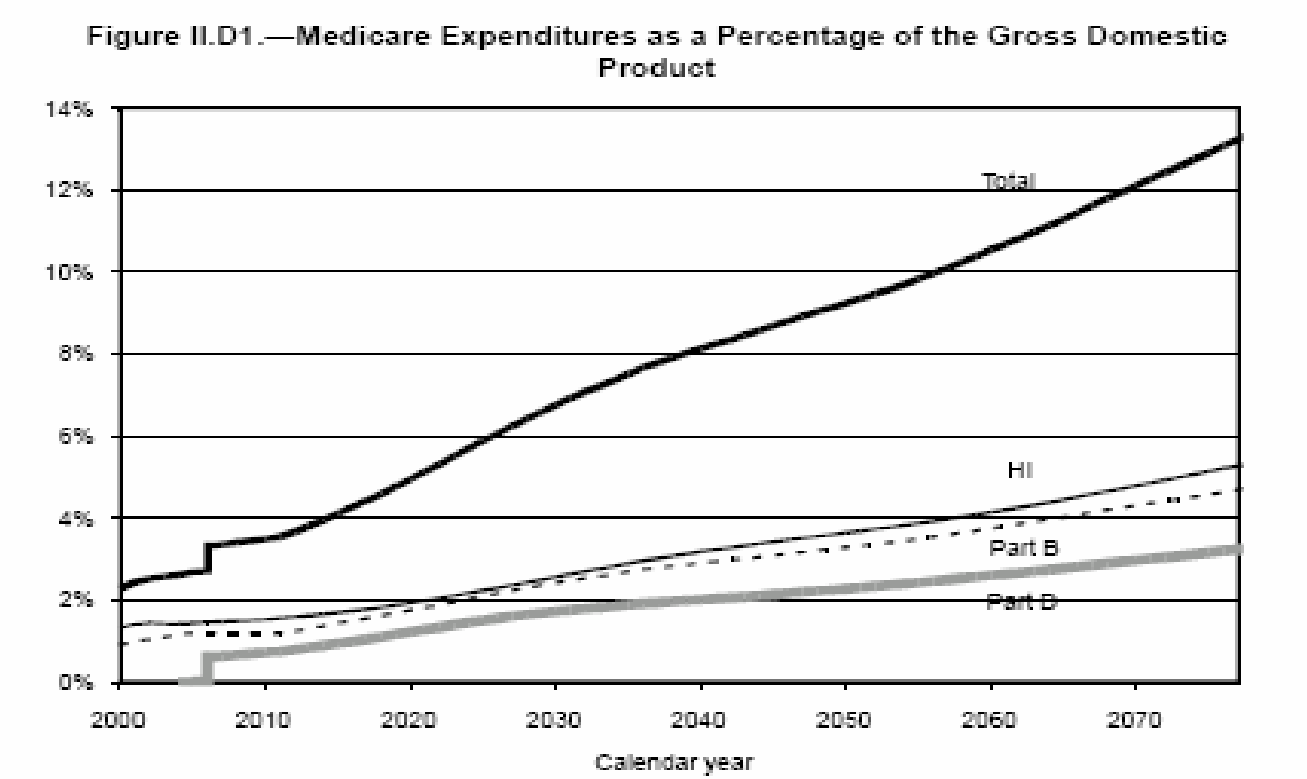
Medicare Financing

Solvency

- Applies only to HI Trust Fund
  - Dedicated revenues for specific expenses

- Trustees Report (2005) projects HI Trust Fund will be exhausted in 2020
  - Annual expenditures exceed income beginning in 2012

Medicare Financing



Source: Medicare Trustees Report 2005

Medicare Financing

"Medicare Funding Warning" (MMA)

- Triggered if Medicare Trustees report in two consecutive years says:
  - General revenue (MMA definition) funding for all of Medicare will exceed 45 percent within next 7 years
- President required to submit proposed legislation for remedial action
- Congress to consider on expedited basis

Medicare Payment

- Possible Approaches
  - Price Taker
  - Price Negotiator
  - Price Setter

- Historical
  - Retrospective Reasonable Cost Reimbursement
  - Reasonable Charges

Medicare Payment

Prospective Payment System Model

- Base payment for unit of service based on historical average cost nationally
- Adjustments made to base payment for
  - Geographic variation in input costs
  - Patient differences affecting service costs
  - Treatment differences affecting service costs
- Updates for inflation and technological change

Medicare Payment

Prospective Payment Systems

- Hospital Inpatient
- Hospital Outpatient
- Psychiatric Hospitals
- Long-Term Care Hospitals
- Ambulatory Surgery Centers
- Skilled Nursing Facility
- Home Health
- Inpatient Rehabilitation Facilities
- Hospice
- Outpatient Dialysis

For Details see: www.medpac.gov Overview of Medicare's prospective payment systems, July 13, 2004

Medicare Payment

Exceptions to the PPS Model

- Physician Fee Schedule—Resource Based Relative Value System (RBRVS)
  - Fees determined by allocating expenditure target among services based on required resources
    - Resources include
      - Physician work (Time, skill, training)
      - Practice expense (Staff, rent, equipment and supplies)
      - Malpractice premiums
  - Updates determined by comparison of actual expenditures and target, inflation and other factors

Medicare Payment

Exceptions to the PPS Model

- Outpatient Laboratory and Durable Medical Equipment (DME)
  - Fee schedule based on charges from 1980's updated for inflation and subject to limits
- DME
  - To be replaced incrementally by competitive bidding (MMA)

Medicare Payment

Issues in payment policy

- Sustainable Growth Rate (SGR) for Physicians
- Pay for performance or quality
- Relative payments across services
- Access in rural areas
- Payment for other purposes (Medical education and indigent care)
- Management of program costs (efficient purchasing)