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# Medicare: Part B Premiums

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## Summary

Medicare is the nation's health insurance program for individuals aged 65 and over and certain disabled persons. Medicare consists of four distinct parts: Part A (Hospital Insurance [HI]); Part B (Supplementary Medical Insurance [SMI]); Part C (Medicare Advantage [MA]); and Part D (the new prescription drug benefit added by the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 [MMA]). The Part A program is financed primarily through payroll taxes levied on current workers and their employers; these are credited to the HI trust fund. The Part B program is financed through a combination of monthly premiums paid by current enrollees and general revenues. Income from these sources is credited to the SMI trust fund. Beneficiaries can choose to receive all their Medicare services through managed care plans under the MA program; payment is made on their behalf in appropriate parts from the HI and SMI trust funds. A separate account in the SMI trust fund accounts for the new Part D drug benefit; Part D is financed through general revenues and beneficiary premiums.

When Medicare began in 1966, the Part B monthly premium paid by beneficiaries was set at a level to finance 50% of Part B costs; general revenues financed the remainder. Legislation enacted in 1972 limited annual premium increases. As a result, beneficiary contributions dropped to below 25% of program costs by the early 1980s. Since the early 1980s, Congress regularly voted to set Part B premiums at levels to cover 25% of program costs. The Balanced Budget Act of 1997 (BBA 97) permanently set the Part B premium at 25% of program costs. Certain low-income beneficiaries are entitled to assistance in paying their Part B premiums. Beginning in 2007, certain high-income Medicare enrollees will pay a higher percentage of their Part B premiums.

*The 2006 monthly Part B premium is $88.50*, a 13.2% increase over the 2005 premium of $78.20. The premium increase is attributable to increases in benefit costs as well as increases needed to assure adequate trust fund reserves. The 2007 monthly premium will be $93.50, an increase of 5.6% over the 2006 amount. The Centers for Medicare and Medicaid Services (CMS, the agency that administers Medicare) reports that the 2007 increase is the smallest percentage increase since 2001. This report will be updated when the 2008 premium is announced.

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## Financing Medicare Part B

### Introduction

Medicare Part B is financed through a combination of beneficiary premiums and federal general revenues. In general, beneficiary premiums equal 25% of estimated program costs for the aged. (The disabled pay the same premium as the aged.) Federal general revenues account for the remaining 75%. Beginning in 2007, higher-income enrollees will pay a higher percentage of Part B costs. The Centers for Medicare and Medicaid Services (CMS, the agency that administers Medicare) estimates that approximately 4% of beneficiaries will pay a higher premium in 2007.[1]

The 2006 monthly Part B premium is $88.50. In 2007, the standard monthly premium will be $93.50, an increase of $5.00 or 5.6% over the 2006 amount. The increase reflects the increase in the costs of health care services funded under Part B. CMS reports that the 2007 premium increase is lower than had been projected earlier in the year. It is also slightly lower than the projected 6% increase in per capita national health spending for 2007.

Individuals receiving Social Security benefits have their Part B premium payments automatically deducted from their Social Security benefit checks. In general, their Social Security checks cannot go down from one year to the next as a result of the annual Part B premium increase.[2] However, this protection does not apply to higher-income persons subject to higher income-related premiums.

Social Security payments are subject to an annual cost-of-living adjustment, or COLA. The 2007 increase of 3.3% represents an average monthly increase of $33 per retired worker.

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[1] CMS, Medicare Premiums and Deductibles for 2007, Fact Sheet, September 12, 2006 [http://www.cms.hhs.gov/apps/media/press/release.asp?Counter=1958].

[2] Specifically, the law provides that if the Part B premium increase is greater than the dollar increase in the annual Social Security cost-of living adjustment, the premium owed by the individual would be reduced to the amount needed to assure no reduction in the Social Security cash payment.

## Premium Calculations for 2007

Each year, Medicare actuaries estimate total per capita incurred costs for the following year. These amounts are established prospectively. Actual spending for the year may be different; and, as a result, income for the year may not equal program costs. Trust fund assets must be maintained at a level to cover a moderate degree of variation between actual and projected costs. This is achieved through a contingency reserve adjustment. The following outlines the calculations for 2007.

**Calculation.**[3,4] The monthly premium for 2007 was calculated as follows. Total monthly benefit costs of $423.18 were reduced by $75.30 for required beneficiary cost-sharing. The resulting amount of $347.86 (rounded) was increased by $7.80 for administrative expenses and reduced by $3.72 for interest earnings. This total of $351.94 was further *increased* by $22.06 for the contingency margin adjustment; this has the effect of increasing the reserves. Twenty-five percent of the resulting net per capita amount of $374.00 yields a 2007 standard premium amount of $93.50.

**Factors Affecting the Calculation.** The premium increase from 2006 to 2007 is attributable to a number of factors. CMS reports that very rapid growth in spending for hospital outpatient services is a major contributor. Although such spending accounts for only 13% of total Part B spending, it accounts for one-third of the increase in the 2007 premium. CMS further notes that outpatient hospital spending accounts for more of the premium growth than spending for physicians services and physician-related services (including lab tests and physician-administered drugs) which together account for a larger share of Part B spending.

Payments under the physician fee schedule account for more than one-third of spending under Part B. The law includes a formula for calculating the annual update to the physician fee schedule. Use of this formula is expected to result in a *reduction* of 5.1% in 2007. (The amount of the actual reduction will be announced when the final physician fee schedule is published later this year.) The 2007 premium calculation is based on current law, and therefore factors in this reduction. It should be noted that Congress overrode similar reductions scheduled to occur for 2003-2006, which had the effect of increasing projected spending for those years. (See the following discussion of contingency reserve). As of this writing, it is not clear whether Congress will take a similar action for 2007. If it does, the financial effect of the increase will first be reflected in the 2008 premium.

**Contingency Reserve.** Another factor contributing to the premium increase is the adjustment for the contingency reserve. Actuaries anticipate the reserves are insufficient to cover contingencies; therefore, an amount needs to be added to the otherwise applicable premium amount.

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[3] Department of Health and Human Services, CMS, *Medicare Program: Medicare Part B Monthly Actuarial Rates, Premium Rates, and Annual Deductible for Calendar Year 2007*, Federal Register, vol.71, no.180, September 18, 2006, 54665.

[4] The actual calculation presented in the regulation shows the numbers for the "monthly actuarial rate" which equals 50% of costs.

For several years, CMS reduced the otherwise applicable premium to draw down an anticipated surplus. However, this changed beginning in 2005. CMS notes that the change in the direction of the contingency adjustment reflects faster-than-anticipated expenditure growth, as well as enactment of three pieces of legislation that increased spending after the Part B premium was announced for the year. These laws were the Consolidated Appropriations Resolution (CAR, P.L. 108-7, enacted in February 2003), the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (MMA, P.L. 108-173), and the Deficit Reduction Act of 2005 (DRA, P.L.109-171, enacted February 8, 2006). CAR increased physician payments for 2003; MMA increased physician payments for 2004 and 2005; and DRA froze 2006 physician payments at the 2005 level (thereby overriding a scheduled reduction).[5]

## Income-Related Premium

Beginning in 2007, Part B premiums are increased for higher-income enrollees. The increase is phased in over three years. In 2007, individuals whose modified adjusted gross income (AGI) exceeds $80,000, and couples whose modified AGI exceeds $160,000, will be subject to higher premium amounts. When fully phased in, higher-income individuals will pay total premiums ranging from 35% to 80% of the value of Part B (See **Table 1**).

The term "modified AGI" means adjusted gross income as defined under the Internal Revenue Code (determined without regard to specified exclusions), increased by tax-exempt interest. In general, the taxable year to be used is that beginning in the second calendar year preceding the year involved. Thus, 2005 income is used to calculate the 2007 premium amount. In the case of certain major life-changing events that result in a significant reduction in modified AGI, an individual may request to have the determination made for a more recent year. Major life-changing events, as defined in proposed rule-making, include death of a spouse, marriage, divorce, partial or full work stoppage, loss of income from income-producing property when the loss is not at the individual's direction (such as in the case of a natural disaster), or reduction or loss of pension income due to termination or reorganization of a pension plan or scheduled cessation of pension benefits.[6]

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[5] For a discussion of these payment increases, see CRS Report RL31199, *Medicare: Payments to Physicians*, by Jennifer O'Sullivan.

[6] Social Security Administration, *Medicare Part B Income-Related Monthly Adjustment Amount*, Notice of Proposed Rule-Making, vol. 71, no. 42, March 3, 2006, 10926.

## Table 1. Percentage of Part B Costs Paid by High-Income Beneficiaries

(in percent)

| Modified AGI Income category* | | Year | | |
|---|---|---|---|---|
| **Single** | **Couple** | **2007** | **2008** | **2009** |
| $80,001-$100,000 | $160,001-$200,000 | 28.3 | 31.7 | 35 |
| $100,001-$150,000 | $200,001-$300,000 | 33.3 | 41.7 | 50 |
| $150,001-$200,000 | $300,001-$400,000 | 38.3 | 51.7 | 65 |
| more than $200,000 | more than $400,000 | 43.3 | 61.7 | 80 |

* Beginning in 2008, the income levels are increased by the increase in the consumer price index for urban consumers, rounded to the nearest $1,000.

**Table 2** shows the 2007 premium amounts. CMS estimates that approximately 4% of Part B enrollees will pay a higher premium in 2007, with less than 1% paying the highest premium amount of $161.40.

## Table 2. Beneficiary Premiums, 2007

| Modified Adjusted Gross Income (AGI) | | Premium |
|---|---|---|
| **Single** | **Couple** | |
| $80,000 or less | $160,000 or less | $93.50 |
| $80,001-$100,000 | $160,001-$200,000 | $105.80 |
| $100,001-$150,000 | $200,001-$300,000 | $124.40 |
| $150,001-$200,000 | $300,001-$400,000 | $142.90 |
| more than $200,000 | more than $400,000 | $161.40 |

**Note:** Married persons who lived with their spouse at some point during the year but who filed separate returns are subject to different premium amounts. Those with incomes greater than $80,000 and less than or equal to $120,000 have premiums of $143.40. Those with incomes greater than $120,000 have premiums of $162.10.

The current law provision, which specifies that a beneficiary's check cannot go down from one year to the next as a result of the Part B premium increase, does not apply to persons subject to an income-related increase in their Part B premiums.

# History of Part B Premium Calculation

## Annual Update

When the program first went into effect in July 1966, the Part B monthly premium was set at a level to finance 50% of Part B program costs. Legislation enacted in 1972 limited the annual percentage increase in the premium to the same percentage by which Social Security benefits were adjusted for changes in cost-of-living (i.e., COLAs). Under this formula, revenues from premiums soon dropped from 50% to below 25% of program costs. This was because Part B program costs increased much faster than inflation as measured by the Consumer Price Index on which the Social Security COLA is based.

From the early 1980s, Congress regularly voted to set Part B premiums at a level to cover 25% of program costs, in effect, overriding the COLA limitation. The 25% provisions first became effective January 1, 1984. General revenues covered the remaining 75% of Part B program costs. Congress took this general approach again in the Omnibus Budget Reconciliation Act of 1990 (OBRA 90). However, OBRA 90 set specific dollar figures, rather than a percentage, in law for 1991-1995. These dollar figures reflected Congressional Budget Office (CBO) estimates of what 25% of program costs would be over the five-year period. Program costs grew more slowly than anticipated, in part due to subsequent legislative changes. As a result, the 1995 premium of $46.10 actually represented 31.5% of program costs.

Omnibus Budget Reconciliation Act of 1993 (OBRA 93) extended the policy of setting the Part B premium at a level to cover 25% of program costs for 1996-1998. As was the case prior to 1991, a percentage rather than a fixed dollar figure was used. This meant that the 1996 premium ($42.50) and the 1997 premium ($43.80) were lower than the 1995 premium ($46.10).

BBA 97 permanently set the premium at 25% of program costs. *If Part B costs increase or decrease, the premium rises or falls accordingly*.[7] (See **Table 3** for a history of Part B premiums.)

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[7] BBA 97 made a change that had the effect of increasing the Part B premium over time. Prior to BBA 97, both Parts A and B of Medicare covered home health services. Payments were made under Part A, except for those few persons who had no Part A coverage. In order to extend the solvency of the Part A (hospital insurance) trust fund, BBA 97 gradually transferred coverage of some home health visits from Part A to Part B. Beginning January 1, 2003, Part A covers only post-institutional home health services for up to 100 visits, except for those persons with Part A coverage only who are covered without regard to the post-institutional limitation. Part B covers other home health services.

## Table 3. Monthly Part B Premiums, 1966-2006

| Year | Monthly premium | Effective date | Governing policy; Legislative authority |
|---|---|---|---|
| 1966 | $3.00 | 7/66 | Fixed dollar amount; Social Security Amendments (SSA) of 1965 |
| 1967 | $3.00 | | Fixed dollar amount; SSA of 1965 |
| 1968 | $4.00 | 4/68 | Fixed dollar amount through March; Medicare Enrollment Act of 1967. Beginning April: 50% of costs; SSA of 1965 |
| 1969 | $4.00 | | 50% of costs; SSA of 1967 |
| 1970 | $5.30 | 7/70 | 50% of costs; SSA of 1967 |
| 1971 | $5.60 | 7/71 | 50% of costs; SSA of 1967 |
| 1972 | $5.80 | 7/72 | 50% of costs; SSA of 1967 |
| 1973 | $6.30 | 9/73 | 50% of costs; SSA of 1967 (COLA limit, added by SSA of 1972, could have applied, but was not needed). Limitations imposed by Economic Stabilization program set 7/73 amount at $5.80 and 8/73 amount at $6.10. |
| 1974 | $6.70 | 7/74 | 50% of costs; SSA of 1967 (COLA limit, added by SSA of 1972, could have applied, but was not needed) |
| 1975 | $6.70 | | Technical error in law prevented updating |
| 1976 | $7.20 | 7/76 | COLA limit; SSA of 1972 |
| 1977 | $7.70 | 7/77 | COLA limit; SSA of 1972 |
| 1978 | $8.20 | 7/78 | COLA limit; SSA of 1972 |
| 1979 | $8.70 | 7/79 | COLA limit; SSA of 1972 |
| 1980 | $9.60 | 7/80 | COLA limit; SSA of 1972 |
| 1981 | $11.00 | 7/81 | COLA limit; SSA of 1972 |
| 1982 | $12.20 | 7/82 | COLA limit; SSA of 1972 |
| 1983 | $12.20 | | Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) had set 25% rule for updates in 7/83 and 7/84. However, SSA of 1983 froze premiums 7/83-12/83 and changed future updates to January. |
| 1984 | $14.60 | 1/84 | 25% of costs; TEFRA, as amended by SSA of 1983 |
| 1985 | $15.50 | 1/85 | 25% of costs; TEFRA, as amended by SSA of 1983 |
| 1986 | $15.50 | 1/86 | 25% of costs; Deficit Reduction Act (DEFRA) of 1984 |
| 1987 | $17.90 | 1/87 | 25% of costs; DEFRA of 1984 |
| 1988 | $24.80 | 1/88 | 25% of costs, Consolidated Omnibus Budget Reconciliation Act of 1985 |
| 1989 | $31.90 | 1/89 | 25% of costs, OBRA 87, *plus* $4 catastrophic coverage premium added by Medicare Catastrophic Coverage Act of 1988 |
| 1990 | $28.60 | 1/90 | 25% of costs; OBRA 89. Medicare Catastrophic Coverage Repeal Act of 1989 repealed additional catastrophic coverage premium, effective 1/90 |
| 1991 | $29.90 | 1/91 | Fixed dollar amount; OBRA 90 |
| 1992 | $31.80 | 1/92 | Fixed dollar amount; OBRA 90 |
| 1993 | $36.60 | 1/93 | Fixed dollar amount; OBRA 90 |

| Year | Monthly premium | Effective date | Governing policy; Legislative authority |
|---|---|---|---|
| 1994 | $41.10 | 1/94 | Fixed dollar amount; OBRA 90 |
| 1995 | $46.10 | 1/95 | Fixed dollar amount; OBRA 90 |
| 1996 | $42.50 | 1/96 | 25% of costs; OBRA 93 |
| 1997 | $43.80 | 1/97 | 25% of costs; OBRA 93 |
| 1998 | $43.80 | 1/98 | 25% of costs; OBRA 93 and BBA 97 |
| 1999 | $45.50 | 1/99 | 25% of costs; BBA 97 |
| 2000 | $45.50 | 1/00 | 25% of costs; BBA 97 |
| 2001 | $50.00 | 1/01 | 25% of costs; BBA 97 |
| 2002 | $54.00 | 1/02 | 25% of costs; BBA 97 |
| 2003 | $58.70 | 1/03 | 25% of costs; BBA 97 |
| 2004 | $66.60 | 1/04 | 25% of costs; BBA 97 |
| 2005 | $78.20 | 1/05 | 25% of costs; BBA 97 |
| 2006 | $88.50 | 1/06 | 25% of costs; BBA 97 |
| 2007 | $93.50* | 1/07 | 25% of costs; BBA 97 (MMA and DRA authorize higher premiums for high-income enrollees.) |

** Approximately 4% of high-income enrollees will pay higher premiums.*

**Source:** Various Annual Reports. The 2006 Annual Report of the Board of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Fund, Mar. 2006, and 71 *Federal Register* 54665, Sept. 18, 2006.

## Income-Related Premium

Since the inception of Medicare, all Part B enrollees have paid the same Part B premium, regardless of their income level. For a number of years, proposals were offered to increase the share of Part B costs borne by higher-income individuals. Many observers suggested that it was inappropriate for taxpayers to pay (through general revenue financing) three-quarters of Part B costs for these persons. They pointed out that low income and middle income working persons might be subsidizing higher-income elderly persons.

The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (MMA, P.L. 108-173) increased the Part B premium percentage for high-income enrollees, beginning in 2007. MMA would have phased in the increase over five years. However, DRA shortened the phase-in period to three years.

At the time of enactment of the MMA provision, the Congressional Budget Office (CBO) estimated that 1.2 million persons (3% of beneficiaries) would pay higher premiums in 2007; and 2.8 million persons (6% of beneficiaries) would pay higher premiums in 2013. CBO further estimated that the MMA provision would reduce federal outlays by $13.3 billion over the 2007-2013 period. CBO estimated

that the DRA provision accelerating the phase-in would increase premium collections by $1.6 billion over the 2007-2010 period.[8]

It should be noted that when CMS announced the premium levels in September 2006, it estimated that 4% of enrollees would be subject to the higher premium amounts. While some persons have labeled the premium change as means testing, the same Part B benefits will be available to all enrollees, regardless of income.

### Changes in 2010

MMA also required the Secretary to establish a six-year program, beginning in 2010, for the application of comparative cost adjustment (CCA) in CCA areas. The CCA program will introduce competition between traditional fee-for-service (FFS) Medicare and local private plans. As a result, an individual residing in a CCA area who is enrolled in Part B of Medicare, but not enrolled in a managed care plan, can have an adjustment to his or her Part B premium, either as an increase or a decrease. No premium adjustment will be made for certain low-income persons. The annual adjustment for a year cannot exceed 5% of the amount of the basic monthly Part B premium, as otherwise determined.

## Assistance for Low Income

Certain low-income beneficiaries are entitled to assistance in paying their Part B premiums. Eligible persons fall into one of the following three coverage groups:

- **Qualified Medicare Beneficiaries (QMBs).** QMBs are aged or disabled persons with incomes at or below the federal poverty level. In 2006, the monthly level is $837 for an individual and $1,120 for a couple[9] and assets below $4,000 for an individual and $6,000 for a couple. QMBs are entitled to have their Medicare cost-sharing charges, including the Part B premium, paid by the federal-state Medicaid program. Medicaid protection is limited to payment of Medicare cost-sharing charges (i.e., the Medicare beneficiary is *not* entitled to coverage of Medicaid plan services) unless the individual is otherwise entitled to Medicaid.

- **Specified Low-Income Medicare Beneficiaries (SLIMBs).** These are persons who meet the QMB criteria, except that their income is

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[8] The MMA estimate and the DRA estimate were each made by CBO at the time of enactment of each law. Both estimates were based on the CBO budget baseline in effect at the time. As is the case for all CBO estimates, the earlier estimates are incorporated into subsequent CBO baselines. Therefore the two savings estimates cannot be added together.

[9] The annual HHS poverty guidelines for 2006 are $9,800 for an individual and $13,200 for a couple; the monthly figures are $817 for an individual and $1,100 for a couple. The qualifying levels are higher because, by law, $20 per month of unearned income is disregarded in the calculation. See [http://new.cms.hhs.gov/DualEligible/downloads/2006DERate.pdf].

over the QMB limit. The SLIMB limit is 120% of the federal poverty level. In 2006, the monthly income limits are $1,000 for an individual and $1,340 for a couple.[10] Medicaid protection is limited to payment of the Medicare Part B premium (i.e., the Medicare beneficiary is *not* entitled to coverage of Medicaid plan services) unless the individual is otherwise entitled to Medicaid.

- **Qualifying Individuals (QI-1).** These are persons who meet the QMB criteria, except that their income is between 120% and 135% of poverty. Further, they are *not* otherwise eligible for Medicaid. In 2006 the monthly income limit for QI-1 for an individual is $1,123 and for a couple $1,505. Medicaid protection for these persons is limited to payment of the monthly Medicare Part B premium. The program is currently slated to expire September 30, 2007.[11]

# Current Issues

## Premium Amount

Despite the fact that the 2007 standard premium amount is somewhat less than previously forecast, the size of recent premium increases has received considerable attention. As noted, an individual's Social Security check cannot go down from one year to the next as a result of an increase in the Part B premium (except for those subject to the income-related premium). However, some observers have suggested that beneficiaries should not face the prospect of losing a large portion of their cost-of-living (COLA) increase.[12] Further, since the hold harmless provision does not apply to the premiums for the new Part D prescription drug program, some persons may see a reduction in their social security checks.[13]

The 2007 premium calculation was based on current law provisions that include a formula for calculating the annual update to the physician fee schedule. As noted earlier, use of this formula will result in a reduction in the fee schedule rates for 2007

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[10] This is calculated the same way as the QMB level. See the preceding footnote.

[11] In general, Medicaid payments are shared between the federal government and the states according to a matching formula. However, expenditures under the QI-1 program are paid for (100%) by the federal government (from the Part B trust fund) up to the state's allocation level. A state is only required to cover the number of persons that would bring its spending on these population groups in a year up to its allocation level. Any expenditures beyond that level are paid by the state. Total allocations are $400 million for both FY2006 and FY2007. The program was initially slated to terminate Dec. 31, 2002, but was extended several times and is now slated to expire Sept. 31, 2007.

[12] See CRS Report RL33364, *The Impact of Medicare Premiums on Social Security Beneficiaries*, by Kathleen Romig

[13] MMA added a new Medicare Part D drug benefit, effective January 1, 2006. It should be emphasized that the cost of this drug benefit is accounted for separately and has no effect on the Part B premium.

(and for a number of subsequent years). Congress overrode similar reductions that were slated to occur in 2003-2006. As of this writing, it is not clear if the Congress will take a similar action with respect to the 2007 update. If it elects to do so, this will have the effect of increasing overall Part B costs, and by extension the Part B premium. Since the 2007 premium amount has already been announced, the increase would first be reflected in the 2008 premium.

## Income-Related Premium

The income-related premium was enacted in response to the concern that lower-income taxpayers should not be financing 75% of Part B costs for the aged. However, some observers have suggested that this might actually represent a first step in moving away from the entitlement nature of the Medicare program. Further, some individuals have suggested that higher-income enrollees might be tempted to drop Medicare Part B coverage. However, at this time, there are few alternatives available for this population in the private insurance market.

## President's Budget

In 2007, the income threshold for higher Part B premiums is $80,000 for an individual and $160,000 for a couple. In subsequent years, the income levels are increased by the percentage increase in the consumer price index (CPI) for urban consumers.

The President's 2007 Budget would eliminate the annual CPI adjustments. This would mean that each year the number of beneficiaries subject to the higher premium would increase. The President's Budget estimated that this change would save $40 million over the FY2008 - FY2011 period. CBO estimated savings of $2 billion over the same period and $15.1 billion over the FY2008-FY2016 period. crsphpgw