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A BRIEF ANALYSIS OF THE SOCIAL SECURITY AND MEDICARE TRUSTEES' REPORT

The new Trustees' report shows that action will need to be taken to shore up Social Security's and Medicare's finances. In evaluating the new report, several points should be kept in mind.

- The most serious financing problems are in Medicare. They primarily stem *not* from the nature of the Medicare program itself, but rather from the continuing sharp rise in health care costs throughout the U.S. health care system, in the public and private sectors alike. For the past 30 years, the increase in costs per beneficiary in Medicare has been nearly identical to the increase in costs per beneficiary systemwide. As David Walker, the Comptroller General, has emphasized, "[F]ederal health spending trends should not be viewed in isolation from the health care system as a whole. For example, Medicare and Medicaid cannot grow over the long term at a slower rate than cost in the rest of the health care system without resulting in a two-tier health care system…."[1]

- Although the Trustees' report estimates that within six years, 45 percent of Medicare funding will come from general revenues, this threshold is misguided: Medicare is *supposed to be* financed in significant part with general revenues. That at least 45 percent of Medicare will be financed with general revenues is no more a problem than that 100 percent of defense, education, or most other federal programs are financed with general revenues. Medicare's basic problem is the degree to which its costs are projected to rise, *not* what *share* of its funding will come from progressive income taxes rather than from regressive payroll taxes.

- Inefficiencies in Medicare's payment policies are worsening the program's financing problems. Congress' expert Medicare advisory commission (the Medicare Payment Advisory Commission, or MedPAC) has found that Medicare is overpaying private insurance companies more than $10 billion per year, and the Congressional Budget Office reports these overpayments are weakening Medicare's finances and accelerating the date of Medicare insolvency.

  Although private insurance companies (which now cover about one-fifth of Medicare beneficiaries) were brought into Medicare on the assumption that they would *save* money for the program, MedPAC and CBO have found the companies are instead being paid *12 percent more* than it costs to treat the same patients under regular Medicare. MedPAC has called on Congress to fix this problem and to pay the insurance companies the same amount — rather

[1] "Long-Term Fiscal Issues: The Need for Social Security Reform," Statement of David M. Walker, Comptroller General of the United States, before the Committee on the Budget, U.S. House of Representatives, February 9, 2005, page 18.

than more — than it costs to cover the same beneficiaries under regular Medicare. CBO has projected this would save $150 billion for the program over the next ten years; the savings would grow substantially larger in subsequent decades.

The MedPAC proposal thus would strengthen Medicare's finances and reduce the magnitude of the benefit cuts or tax increases that ultimately will be needed. The findings in the new Trustees' report underscore how important it is for Congress to act on the MedPAC recommendations, and to stand up to the health insurance companies despite the multi-million-dollar lobbying campaign the companies are mounting to protect their overpayments.

- The Trustees' report indicates that the problems in Social Security should be less difficult to address than those in Medicare. Social Security will be able to pay 100 percent of promised benefits until 2041 (the year in which the Trustees predict the trust fund will be exhausted) and 75 percent of promised benefits after that (declining to 70 percent in 2081). The data in the Trustees' report portray a program that has a substantial long-term funding shortfall that must be addressed, but not a program with a devastating structural crisis.

- The data on Social Security in the Trustees' report also offer some broader fiscal perspective. The Trustees place the size of the Social Security shortfall at 0.7 percent of the Gross Domestic Product (or $4.7 trillion in present value over 75 years). The cost of extending the 2001 and 2003 tax cuts over the same 75-year period is an estimated 2.0 percent of GDP (or $14.4 trillion in present value).[2] In other words, the cost over the next 75 years of making the tax cuts permanent will be about *triple* the size of the Social Security shortfall. (Moreover, the cost over 75 years of the tax cuts just for the top 1 percent of Americans — people with annual incomes over $400,000 in today's dollars — is nearly equal to the cost of closing the Social Security shortfall.)

These various findings underscore the need for the President and Congress to develop a balanced, equitable plan to address the long-term challenges the nation faces. Such a plan will need to include reforms in the overall U.S. health care system and the tax code as well as reforms in Medicare and Social Security.

45-Percent "Trigger" a Distraction From Medicare's Real Financial Problems

As noted, the Trustees' report contains a projection that the share of Medicare funding that comes from general revenues will reach 45 percent within the next six years (in 2013). This is the second year in a row that the Trustees' report has included such a projection. Under a provision of the 2003 prescription drug law, when two consecutive Trustees' reports contains such a projection, the President's next budget must propose changes in Medicare that would reduce this share below 45 percent.

Unfortunately, the pulling of this "trigger" is likely to distract policymakers from Medicare's real financial problems, because the 45-percent standard is fundamentally unsound and of little value in evaluating Medicare's challenges. Medicare coverage for physician and outpatient services and the new Medicare drug benefit are supposed to be financed with general revenues (as well as beneficiary premiums), rather than with payroll taxes. As noted above, Medicare's basic problem is how much

[2] This assumes continuation of the so-called tax "extenders" and relief from the Alternative Minimum Tax.

its costs are projected to rise, not what share of its funding will come from general taxes rather than payroll taxes.

In addition, the misguided 45-percent standard is likely to make it more difficult to address Medicare's financing problems because it effectively rules out using any increase in general revenues as part of a larger reform package to help put Medicare and the overall federal budget on a sound financial footing. Under the 45-percent standard, increases in regressive payroll taxes would be allowed as part of a reform package, as would be increases in beneficiary premiums and cuts in Medicare benefits. But increases in progressive income taxes — such as from paring back some of the Administration's tax cuts for people at the top of the income scale or curbing corporate tax shelter abuses — could not be used to meet the 45-percent standard, thereby discouraging their use as a way to help fill Medicare's gap.

Medicare's financing problems are large, and all options need to be on the table. The unseemly protection of tax cuts for wealthy individuals and corporations that the 45-percent standard provides is likely both to make agreement on a balanced Medicare reform package harder to achieve and to increase pressure down the road for deeper Medicare benefit cuts or larger increases in regressive payroll taxes.